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REPUBLIC OF ARMENIA

November 2015

SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVERS OF NONOBSERVANCE AND REPHASING—PRESS RELEASE; STAFF REPORT; SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE REPUBLIC OF ARMENIA

In the context of the Second Review Under the Extended Arrangement and Request for Waivers of Nonobservance and Rephasing, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 6, 2015, following discussions that ended on September 25, 2015, with the officials of the Republic of Armenia on economic developments and policies underpinning the IMF arrangement under the Extended Fund Facility. Based on information available at the time of these discussions, the staff report was completed on October 22, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Republic of Armenia.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of the Republic of Armenia*
Technical Memorandum of Understanding*
*Also included in Staff Report

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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Press Release No. 15/501
FOR IMMEDIATE RELEASE
November 6, 2015

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Second Review of Armenia's Extended Arrangement, Approves US$16.3 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) completed today the second review of Armenia's performance under a three-year arrangement under the Extended Fund Facility (EFF). The completion enables the release of SDR 11.74 million (about US$16.3 million), bringing total disbursements under the arrangement to SDR 35.22 million (about US$48.9 million). The extended arrangement for SDR 82.21 million (about US$114.1 million) was approved on March 7, 2014 (see Press Release No. 14/88).

In completing the review, the Executive Board also approved the authorities' request for waivers of non-observance of the end of June 2015 performance criteria (PC) on net international reserves (NIR), net domestic assets (NDA) of the Central Bank of Armenia (CBA), and the fiscal deficit, as well as the authorities' temporary nonobservance of the PC on non-introduction or modification of multiple currency practices (MCPs). At the same time, the authorities' policy actions have helped forestall a potentially disorderly adjustment and maintain stability and economic growth.

Following the Executive Board's discussion on Armenia, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, said:

"Armenia's performance under the program has been adversely affected by weaker-than-expected external conditions and deviations from some program policies. The authorities' policy response has helped mitigate the initial impact of the shocks but the outlook remains challenging. Steadfast implementation of the agreed measures will be necessary to meet the objectives of the Fund-supported program, rebuild buffers and policy space, and unlock Armenia's growth potential.

"Going forward, it is important to return to greater exchange rate flexibility and to limit interventions to preserve and strengthen buffers and to support external adjustment.

Monetary policy should be carefully calibrated to maintain price stability. Gradual normalization of monetary conditions through unwinding of the emergency measures introduced in 2014 would also help support a resumption of bank lending and growth. Enhancing communication with the public, business community and other stakeholders on key policy directions will be important for building consensus on policy responses.

"After a period of fiscal easing to support activity, fiscal consolidation will be needed to ensure debt sustainability. Adjustment should focus on revenue gains to protect and increase capital and social spending and support medium-term growth. The new tax code provides an opportunity to broaden the tax base by eliminating exemptions and addressing gaps and thereby to support both consolidation and increases in growth-enhancing spending.

"The banking sector remains stable, and strengthening crises preparedness and management frameworks will increase the robustness of the financial system. Introducing a financial rehabilitation plan for the electricity sector and pursuing structural reforms to enhance competition, competitiveness and regional and global integration remain critical to reduce vulnerabilities and support broad-based growth."

Table 1. Armenia: Selected Economic and Financial Indicators, 2010–17

	2013	2014	2015		2016	2017
	Act.	**Prel.**	**EBS/14/148 1/**	**Proj.**	**Proj.**	**Proj.**
National income and prices:						
Real GDP (percent change)	3.5	3.4	3.3	2.5	2.2	2.8
Gross domestic product (in billions of drams) 2/	4,556	4,843	4,867	5,122	5,443	5,816
Gross domestic product (in millions of U.S. dollars)	11,121	11,644	11,278	10,607	10,672	11,074
CPI (period average; percent change)	5.8	3.0	3.8	4.3	3.4	4.0
CPI (end of period; percent change)	5.6	4.6	3.6	3.4	4.0	4.0
GDP deflator (percent change) 2/	3.1	2.8	4.0	3.2	4.0	4.0
Investment and saving (in percent of GDP)						
Investment	22.6	21.1	22.6	18.9	19.5	20.3
National savings	15.0	13.8	15.3	14.0	13.7	14.3
Money and credit (end of period)						
Reserve money (percent change)	29.9	-0.1	9.3	4.9	4.8	6.7
Broad money (percent change)	15.2	8.9	11.0	6.8	6.3	6.8
Central government operations (in percent of GDP)						
Revenue and grants	22.2	22.0	23.8	21.5	21.2	21.8
Of which: tax revenue 3/	21.0	21.0	22.5	20.1	20.0	20.6
Expenditure 4/	23.8	23.9	26.1	25.4	24.7	24.3
Overall balance on a cash basis	-1.0	-2.1	-2.3	-3.9	-3.5	-2.5
Public and publicly-guaranteed debt (in percent of GDP)	40.8	43.1	44.8	48.2	50.6	51.6
Share of foreign currency debt (in percent)	85.2	86.1	84.9	88.5	87.7	86.7
External sector						
Exports of goods and services (in millions of U.S. dollars)	3,156	3,319	3,089	3,226	3,215	3,279
Imports of goods and services (in millions of U.S. dollars)	-5,365	-5,468	-5,199	-4,634	-4,693	-4,796
Exports of goods and services (percent change)	8.2	5.2	6.0	-2.8	-0.3	2.0
Imports of goods and services (percent change)	4.6	1.9	3.0	-15.3	1.3	2.2
Current account balance (in percent of GDP)	-7.6	-7.3	-7.3	-4.9	-5.8	-6.0
FDI (net, in millions of U.S. dollars) 5/	508	388	372	334	438	448
Debt service ratio (in percent of exp. of goods and serv.) 6/	27.9	8.4	5.9	5.8	6.6	7.6
Gross international reserves (in millions of U.S. dollars)	2,253	1,489	1,989	1,712	1,779	1,927
Import cover 7/	4.9	3.9	4.4	4.4	4.5	4.7
Nominal effective exchange rate (percent change) 8/	-0.9	-1.5	…	…	…	…
Real effective exchange rate (percent change) 8/	1.2	-0.3	…	…	…	…
End-of-period exchange rate (dram per U.S. dollar)	405.6	475.0	…	…	…	…

Average exchange rate (dram per U.S. dollar)	409.6	415.9		…	…	…	…

1/ Staff Report for the First Review and 2014 Article IV Consultation.
2/ In the first quarter of 2015 the authorities started calculating GDP using the SNA 2008 methodology. They have revised GDP series from 2012 on, but pre-2012 series remain calculated using the SNA 1993 methodology. The Staff Report for the First Review and 2014 Consultation was calculated using the pre-revision series.
3/ In 2013, tax revenue includes social contribution.
4/ In 2013 includes 1.5 percent of GDP related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom, and the transfer (expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities. A surplus of 0.6 percent of GDP is obtained when this transaction is excluded.
5/ In 2013m a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offsetting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the later with the former.
6/ Based on public and publicly-guaranteed debt.
7/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.
8/ A positive sign denotes appreciation.

REPUBLIC OF ARMENIA

October 22, 2015

SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVERS OF NONOBSERVANCE AND REPHASING

KEY ISSUES

Background. Since late 2014, Armenia's economic performance has been affected by significantly weaker external conditions, as the slowdown of the Russian economy, the weakening of the ruble, lower metals prices, and the strengthening of the dollar have led to pressures on external receipts, particularly remittances. Domestic conditions have also weakened, including banking sector credit. These factors have translated into pressures on the foreign exchange (FX) market and depreciation of the dram and a wider fiscal deficit, but also a significant adjustment of the external current account deficit. The more complex economic environment, together with deviations from program policies, has also contributed to delays in concluding the Second Review.

Outlook and risks. The outlook is challenging. Growth in 2015 has held up on account of one-off factors in mining and agriculture, but performance in other sectors has been weak. Growth is expected to remain subdued in 2016 and into the medium term, underscoring the need for decisive implementation of reforms. Important risks include a further weakening of the external environment and adverse regional geopolitical developments. By contrast, if activity in Russia strengthens, conditions will improve.

Program performance. Performance under the program has come under strain. Three PCs—on net international reserves (NIR), net domestic assets (NDA) of the Central Bank of Armenia (CBA), and the fiscal deficit—were missed both at end-December 2014 and end-June 2015. This reflected both the magnitude of the external shock and deviations from program policies, including heavy FX intervention, larger-than-expected budgetary lending, policy changes that affected VAT revenues, and difficulties in introducing electricity tariff and excise tax increases. The authorities also breached the continuous PC on the introduction or modification of multiple currency practices (MCPs). At the same time, the authorities' policy actions have helped forestall a potentially disorderly adjustment and maintain stability.

Policy discussions. Discussions focused on the response to the challenging environment, both in the near term and in the medium term, by rebuilding buffers and policy space and stepping up reforms needed to strengthen growth. The strategy to bring the program back on track involves: (i) balancing near-term fiscal stimulus with medium-term consolidation in light of rising debt; (ii) unwinding emergency monetary measures and moving back to a more flexible exchange rate (ER); (iii) strengthening crisis preparedness and management frameworks; (iv) introducing a financial rehabilitation plan for the electricity sector; and (v) structural reforms to enhance competition, competitiveness and regional and global integration. Staff and the authorities agreed that greater clarity and consensus on the policy response and enhanced communications with the public, the business community, and other stakeholders are needed.

Program issues. The authorities are requesting waivers of nonobservance for the missed June and continuous PCs. They are also requesting rephasing of the program's remaining reviews and disbursements, so that there will be three remaining reviews, with proposed access of SDR 15.65 million for two reviews and SDR 15.69 for the final review. The arrangement would conclude as planned in May 2017. Staff supports the authorities' requests for waivers and rephasing, as a key factor affecting program performance has been the significant deterioration of external conditions, deviations have been temporary, and corrective actions have been taken. The authorities' response helped forestall a worse outcome, and the agreed policy framework should help achieve the program's objectives, especially tax and energy sector reforms and greater transparency around budget lending. The authorities are expected to catch up with their reform agenda within the existing timeline.

Approved By:
Juha Kähkönen and Steven Barnett

Discussions were held February 4–12, March 25-April 9, June 29-July 2, and September 10-25 in Yerevan with President Sargsyan, Prime Minister Abrahamyan, Deputy Prime Minister Gabrielyan, CBA Chairman Javadyan, Finance Minister Khachatryan, Economy Minister Chshmarityan, Energy and Natural Resources Minister Zakharyan, other senior officials, and representatives of the private sector, civil society, and the diplomatic community. The Fund team comprised M. Horton (head), X. Fang, F. Parodi, P. Rodriguez, and Y. Sobolev (all MCD), Z. Arvai (SPR), R. Rozenov (FAD), and M. Souto (MCM). T. Daban (Resident Representative) and M. Aleksanyan, A. Manookian, and V. Janvelyan (IMF Office) assisted. A. Hubic (OED) joined the discussions. N. Aivazova, M. Fischer, C. Prado de Guzman, and S. Salimi (MCD) contributed to the staff report.

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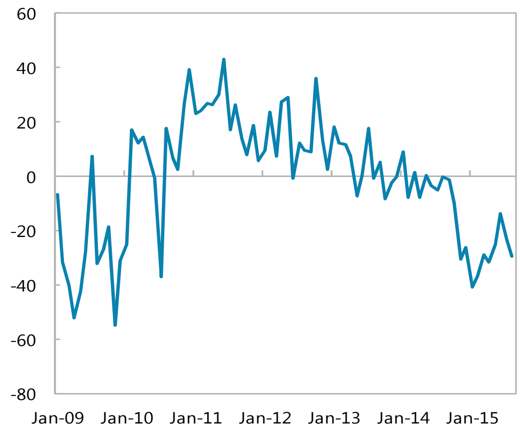
CONTEXT AND RECENT DEVELOPMENTS

1. **Armenia's economic environment worsened in late 2014 and 2015.** This reflected the weaker outlook in Russia—Armenia's largest trading partner and a key source of remittances, financing and investment—and lower prices for mining exports. The weaker ruble affected exports to Russia and remittances, which fell by 32 percent y-o-y during November 2014-August 2015. The current account deficit has narrowed, as imports of goods declined by 25 percent in the first half of 2015, while favorable weather conditions boosted agriculture production and exports, along with a new copper mine. A mild winter eased gas imports, and a gas price discount of nearly 15 percent for 2015 was agreed with Russia and Gazprom.

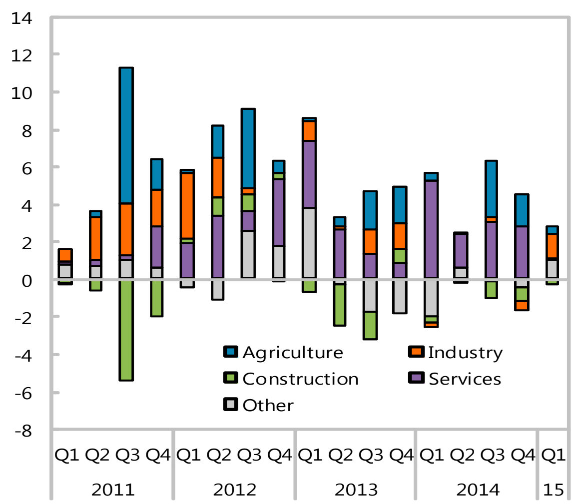
Remittances
(USD, in YoY Percent Change)



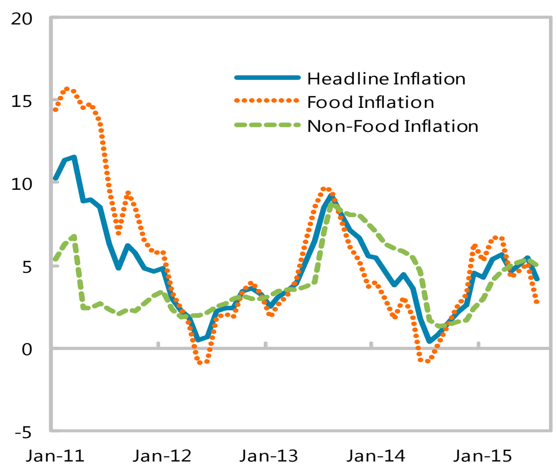
Source: National authorities.

2. **Growth has held up due to one-off factors, and inflation has returned to the target range**. Growth was 3.9 percent in the first half, driven by mining and agriculture. Other sectors slowed, and consumption declined. Following a 16½ percent depreciation of the dram in Q4 2014, inflation reached 5.8 percent in March, above the target (4 percent with ±1.5 percent confidence band), but eased to 3.2 percent in September with lower food prices.

Sectoral Contributions to Growth
(In Percent, Production Approach)

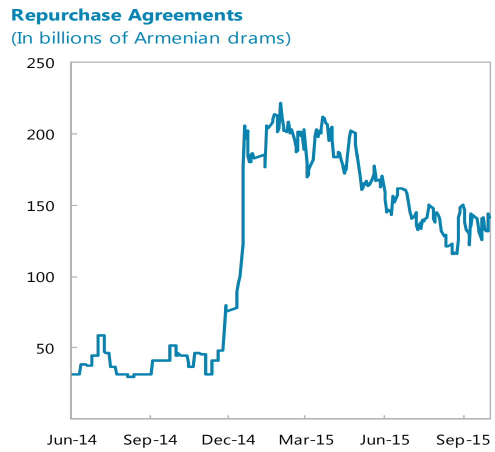


Consumer Price Inflation
(In Percentage Change)



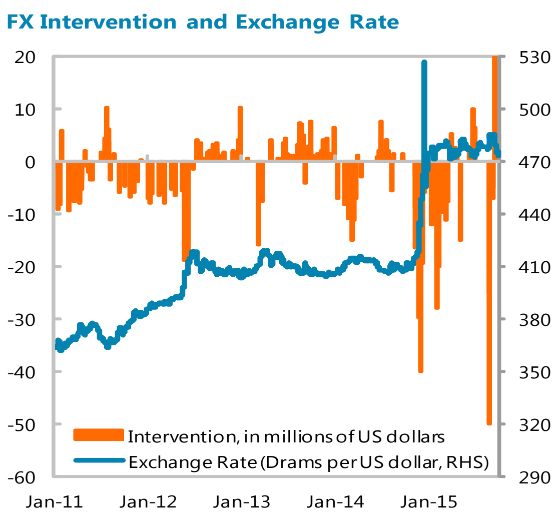
Sources: National Authorities; and IMF staff calculations.

3. The CBA took actions in late 2014 and early 2015 to forestall a disorderly ER adjustment. After large FX sales in November, the CBA introduced daily FX auctions in December. However, sustained pressures led to conversion and outflow of deposits, which led the CBA to double FX reserve requirements (RRs) (held in dram) and to sharply increase Lombard interest rates. FX sales continued through March, diminishing monthly.

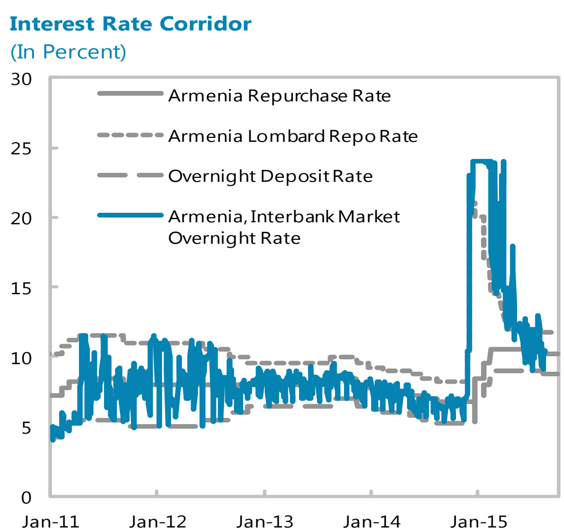


Source: National Authorities.

4. Conditions stabilized, although transitory pressures reemerged in August. The dram stabilized with tight liquidity conditions, and from April through mid-August, the CBA purchased FX and restored its interest rate corridor, reducing the Lombard rate and raising the policy rate. FX RRs were cut from 24 to 20 percent, although CBA dram liquidity support, which spiked to help banks meet higher FX RRs, remains high. ER pressures reemerged in August with depreciation of the Kazakh tenge and volatility in China, and the CBA again sold FX. However, the market calmed, and the CBA has repurchased some dollars.

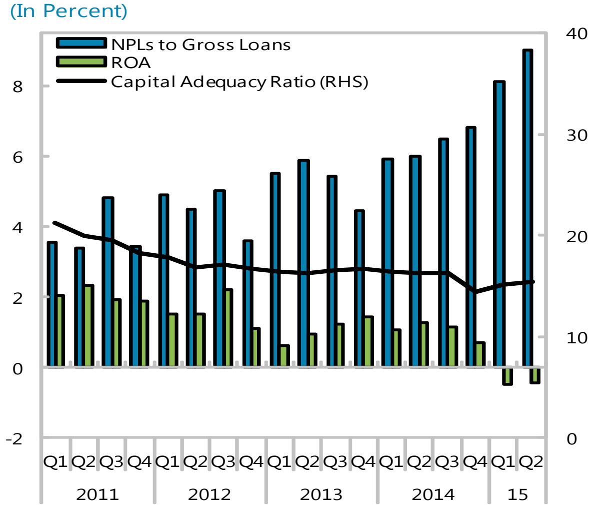


Source: National authorities.

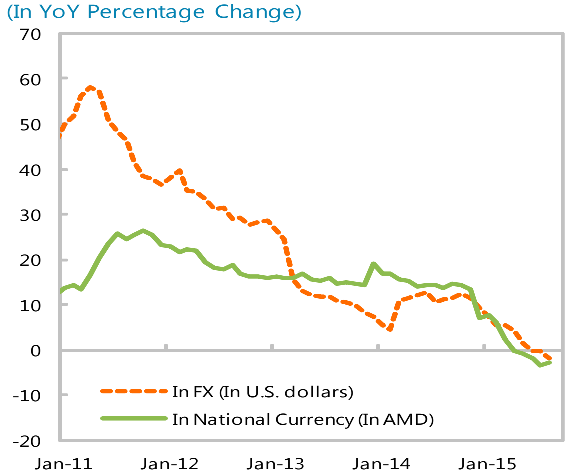


5. Banking performance has weakened, although the sector remains stable. Following deposit outflows in December, liquidity indicators stabilized, and the CBA stepped up its monitoring of banks, including more frequent stress testing.[1] Bank profitability has declined as the cost of funding has remained high, and nonperforming loans (NPLs) increased, reaching 8.6 percent in July 2015 (from 6 percent last June); the pick-up of NPLs was higher for FX loans (from 6.2 in June 2014 to 9.4 in July 2015). Credit growth (in volume) slowed from 13 percent in June 2014 to -5 percent in August 2015. In January, the CBA increased bank minimum capital requirements from AMD 5 billion to AMD 30 billion by 2017, with the aim of increasing buffers and efficiency. Discussions of new funding and mergers/acquisitions are underway.[2]

Financial Soundness Indicators
(In Percent)



Credit Growth
(In YoY Percentage Change)



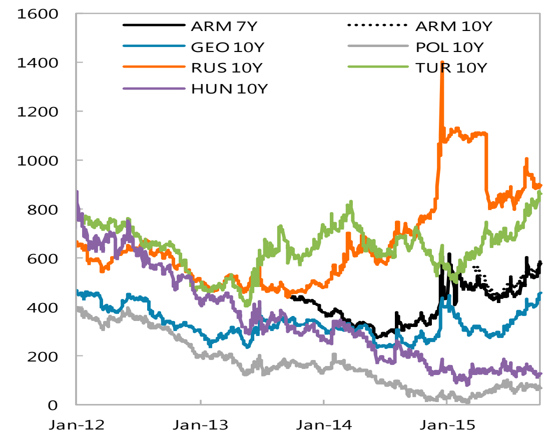
Sources: National Authorities; and IMF staff calculations.

[1] Stress tests show that system-wide capital could fall below 12 percent in a combined interest rate, credit, and FX shock, although all banks would remain solvent. Capital needs would amount to 2 percent of GDP. The most serious risk is credit risk, particularly regarding the potential impact of an adverse macroeconomic scenario on the performance of FX loans. Direct FX risk is small, as banks' open FX positions are just a small share of capital.

[2] Nearly a third of banks already meet the requirement; other banks have provided plans to raise capital. Without mergers, additional capital needs are estimated at $500 million.

6. Fiscal performance has experienced challenges. The 2014 headline deficit was 2.1 percent of GDP, below the 2.3 percent of GDP target. Revenues fell short, but were offset by lower spending, mainly capital underspending. Revenues have slowed in 2015, due to weaker activity and policy changes.[3] With lower EEU-wide imports, customs pool transfers have been lower than expected. With revenue underperformance and rising risks, the authorities issued a $500 million, 10-year Eurobond in March.[4] Spreads have experienced substantial volatility since late 2014.

International Bond Spreads
(In Basis Points over Comparable US Treasuries)



Source: Bloomberg and IMF staff calculations.

7. Progress in structural areas has been mixed. Positive developments included opening of a major new copper mine, licensing of a big new gold mine, and sale of a large hydroelectric complex. The authorities agreed with Russia on $300 million of concessional funding to extend the life of the Metsamor nuclear station. The Nairit synthetic rubber factory has entered bankruptcy. However, progress on the flagship North-South Highway and deregulation projects lagged, and electricity sector finances deteriorated. Increases in electricity tariffs in June were suspended following protests. Armenia became a full member of the EEU in January. Membership is expected to reduce non-tariff barriers and facilitate employment arrangements for Armenians in Russia.

8. A referendum on constitutional reform is planned for December. The referendum will consider changing the country's governance from a semi-presidential to a parliamentary arrangement. Changes would limit the role of future presidents and of smaller parties in future coalitions. Parliamentary and presidential elections are due in 2017 and 2018, respectively.

OUTLOOK AND RISKS

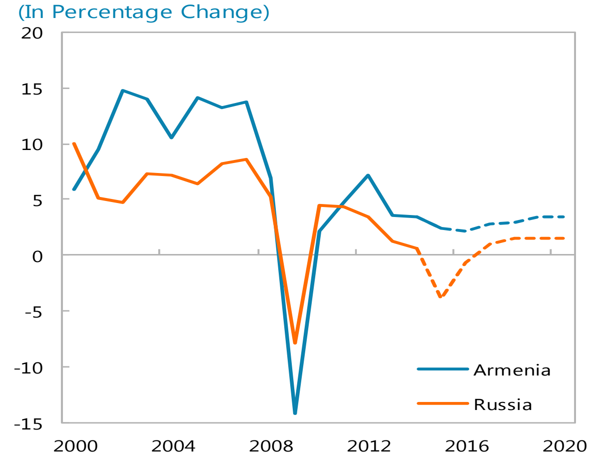
9. The outlook is challenging. Activity is expected to remain subdued in 2015–16 and pick up gradually thereafter, in line with recovery in Russia. As growth has been supported by one-off factors in 2015 (weather, copper mine), there are prospects for difficulties in 2016, as credit has slowed and copper prices have declined. However, industrial production and services have held up in 2015; this is expected to continue in 2016, and staff projections reflect stabilization in sectors

[3] These included: elimination of the minimum profits tax, reduction of the turnover tax rate, extension of the payment date for VAT collections for imports from Eurasian Economic Union (EEU) countries, and a shift to accrual reporting for the VAT.

[4] Part of the proceeds was used to buy back $200 million of the 2013 Eurobond.

where low or negative growth has been recorded in 2015 (construction, trade). Fiscal easing in 2015 should provide support, along with growth of exports to the Middle East and further inroads in EEU markets. Medium-term growth (3½ percent) should be lower than at the time of the First Review (by 1 percent). The authorities consider that growth will be higher, led by agriculture, mining, and services. Inflation should remain within the target range, given subdued domestic demand and lower commodity prices. Fiscal adjustment should commence in 2016 to stabilize and reduce debt (Annex I). The current account deficit is expected to narrow to its lowest level since 2006 (Annex II). A key issue is the durability of the external adjustment as 2015 exports were boosted by favorable weather for agricultural exports and as copper exports may be impacted by low prices and profitability. Imports may also rebound as some contraction in 2015 was due to higher 2014 imports in anticipation of higher EEU tariffs and mild winter gas imports. Reserve coverage has been buoyed by borrowing and is below IMF metrics for a non-floating ER.

Growth Correlation with Russia
(In Percentage Change)



Sources: National authorities.; and IMF WEO.

10. Near-term risks are weighted to the downside (Annex III). These include the outlook in Russia, lower metals prices, tighter global conditions and higher borrowing costs, and conflict with Azerbaijan. Continued policy weaknesses are another risk. Medium-term risks are more balanced: Russia's recovery could accelerate, and upside developments could occur in mining, agriculture and tourism, and on Iran, if sanctions are eased. The authorities broadly concur with the risks identified by staff and the assessment of likelihood and possible impact.

SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT

Three June PCs and one continuous PC were missed, and lack of policy consensus and clarity contributed to delays in concluding discussions on the Review. While performance has weakened, the authorities' efforts should bring the program back on track, in terms of actions taken, as weaknesses in implementation are addressed, and as agreed measures are put in place. The strategy focuses on: unwinding emergency monetary measures and implementing a clearer and more flexible ER policy; strengthening crisis preparedness; fiscal support in 2015 and consolidation from 2016; reforms to support growth and address vulnerabilities, notably in energy; and enhanced communications.

A. Program Performance

11. Several December and June PCs were missed, and conclusion of discussions on the Review was delayed. CBA NIR and NDA PCs were missed due to FX sales and liquidity support in the face of FX market pressures. The fiscal deficit PC was missed due to lower tax revenues and budgetary lending above programmed amounts.[5] [6] The continuous PCs on external arrears and absorption of liabilities were met, but the continuous PC on non-introduction or modification of MCPs was missed. For June, the indicative floor on social expenditures and the indicative target for inflation were missed by narrow margins. Conclusion of the Second Review, initially expected by June, was delayed by the need to clarify the fiscal response to adverse developments (including budget lending, excise tax increases, and financing of a subsidy to compensate for postponement of the electricity tariff hike). The authorities are requesting waivers of nonobservance for the missed PCs, based on corrective actions they have taken.[7]

12. Progress was made on structural measures (MEFP Table 2). The authorities implemented measures to strengthen reporting and reduce the shadow economy (December SB) and completed both a policy paper assessing CBA liquidity regulations and reserve requirements (March SB) and an analysis of capital underspending (April SB). They drafted legislation to simplify bankruptcy procedures (June SB), and made progress on proposals to strengthen tax collections from high-wealth individuals (HWI) and to assess CBA-owned firms involved in financial development and architecture (June SBs), although further work is needed in these areas.[8] [9] While a study of energy policy options was not completed on time (December SB), a new strategy for 2016-36 was issued in May, and the authorities are working closely with the World Bank on energy issues. The last phase of the regulatory guillotine program experienced hurdles, but is now moving ahead.

B. Policy Discussions

Exchange Rate and Monetary Policies

13. ER policy has relied less on FX intervention in recent months. Early in 2015, the CBA continued FX sales, given seasonal demand (gas) and concerns that sharp ER moves could reignite deposit withdrawals. January and February interventions—$85 million and $56 million—exceeded

[5] Budget lending, which is recorded as a financing item, is *excluded* from the calculation of the program fiscal balance, effectively treating lending as an expenditure when loans are made and as a revenue when loans are repaid.

[6] Understandings were reached on June PCs in September 2014, and they were established in December. They were not revisited or reset, due to delays in concluding the reviews.

[7] These are described in the attached LOI/MEFP and include refraining from FX intervention and a new PC and SBs on budgetary lending.

[8] In particular, while the SB on proposals to strengthen tax collections from HWI was met formally—a document was submitted to Cabinet—the proposals were not specific in terms of timing, required steps, or potential yields.

[9] Progress has also been made in implementing the recommendations of the August 2014 Safeguards Assessment (see Informational Annex).

the level on which staff reached understandings with the authorities in December 2014 for Q1. While staff saw the case for greater ER flexibility, the authorities remained concerned with financial stability, noting the more rapid increase of FX NPLs and risks of further deposit withdrawals or conversions. As seasonality and uncertainty on regional currencies eased, the CBA bought dollars from late March. Sales again occurred in August, although the CBA has since repurchased part of that intervention; YTD intervention remains below revised targets agreed with staff.

14. Key objectives are to maintain buffers, return to greater ER flexibility, and strengthen communications. Given the high degree of dollarization and a current account deficit still around 5 percent of GDP, the authorities and staff agreed on the importance of limiting intervention to preserve buffers and support external adjustment. While reserves remain above some benchmarks, they are below metrics for a non-floating ER regime, while the high degree of dollarization also suggests higher reserves (Annex II). Accordingly, the CBA committed to strictly limiting net FX sales, stressing the need to avoid leaning against the wind. The CBA indicated that its new intervention approach will help achieve flexibility.[10] Staff estimates suggest that the dram now broadly reflects its fundamentals, with some moderate real overvaluation over the medium term.

15. Monetary policy will remain focused on inflation stabilization; further unwinding of last year's emergency measures will also depend on external conditions. While monetary policy remains tighter than before FX pressures emerged, the CBA has gradually reversed emergency measures taken in December. A key step has been reestablishing the policy rate as the main benchmark by increasing standard repo operations while reducing Lombard repos and the Lombard rate. With inflation in August below the CBA's target of 4 percent, and with demand subdued, there is scope for additional easing. However, the CBA remains concerned that global market volatility could spill over, with consequences for inflation expectations. As a result, the CBA has been cautious in its easing cycle. Staff and the CBA agreed that inflation stabilization should remain the main factor for the pace of unwinding, with staff noting that tight conditions could restrain intermediation and lead the real ER to deviate from fundamentals. Staff stressed that if FX pressures reemerge and persist, adjustment of the dram would be needed. Monetary policy may need to be tightened, although not to an extent that would suggest efforts to support a particular ER level.

Financial Sector Policy

16. Program measures have aimed to strengthen contingency planning, safety nets, and risk assessment. The authorities have enhanced crisis preparedness and management, including by undertaking contingency planning exercises and requiring banks to submit crisis plans. A proposal to double the coverage of the deposit guarantee fund (DGF) was submitted to parliament, with legislation to shorten the payout period for depositors. The DGF improved the regulation for the composition of its board, formalized its access to CBA liquidity, and adjusted procedures to prevent

[10] The CBA's new approach (both for FX sales and purchases) is an extension of the multiple-price auction framework introduced in December 2014. The approach is expected to be a better price discovery mechanism than outright sales or purchases at specific prices.

use of its resources outside its core mandate. The CBA has enhanced its stress testing to ensure that credit risk is better captured. More broadly, staff and the authorities agreed that the legal framework is broadly sound and that the CBA has wide-ranging tools to intervene if capital is deteriorating and solvency is at risk. The authorities pledged to continue close monitoring of the banks, and if conditions weaken, to intensify their asset quality review for the most-affected banks.

17. The CBA has taken measures to increase the resilience and efficiency of the banking sector. It has communicated to banks on additional capital increases that may be needed given the deteriorating environment and has required banks to increase their minimum capital six-fold by 2017. The CBA argued that higher capital would boost buffers, stimulate consolidation, and lead to greater efficiencies and scale (particularly within the EEU). Nearly a third of banks already meet the new requirement, and other banks have provided plans to raise capital. The CBA and staff agreed that banks should increase funding from private investors or IFIs and not utilize CBA or government financing. The CBA will divest its ownership of a development bank, PanArmenian Bank.

Fiscal Policy

18. The weaker environment has made attainment of the 2015 budget objectives difficult. Revenue projections for 2015 were based on growth of 4 percent, well above current projections. Revenues have been affected by the shock and by policy changes—new incentives and EEU-related changes. The authorities and staff also agreed on the desirability of additional capital spending, focused on roads and schools. The 2015 headline deficit will likely be around 4 percent of GDP. While this level and the targets for 2016-17 are above the debt-stabilizing deficit of 2 percent of GDP, the larger deficit and higher capital spending will help sustain activity and boost medium-term growth. The authorities have secured additional concessional financing from the Eurasian Fund for Stability and Development (former Anti-Crisis Fund). A long-term, low-interest $200 million loan was also agreed with Russia for defense, partly explaining the capital spending increase in the fiscal accounts.[11]

19. The authorities have stepped up budget lending to support activity. They made a large loan to a mining project in 2014 to boost activity, exports, and employment. They also increased lending in 2015, targeted to capital and real estate projects and to reducing interest payments on local bank loans to SMEs in agriculture. Some of the 2015 loans will be funded by sale of physical assets. Staff noted that past lending arrangements involving interest subsidies and risk sharing with local banks have worked well; however, larger, direct loans should be limited to minimize risks and retain buffers. Staff and the authorities agreed on a new PC (ceiling) for domestic lending, as a corrective action for the missed deficit PC and to enhance transparency. The government will also publish periodic consolidated statements across domestic lending programs and conduct a risk-based review of its lending (new SBs).

[11] Following GFSM 2014, the authorities classify expenditure on military equipment as acquisition of non-financial assets.

20. Consolidation is needed from 2016 to ensure debt sustainability. An update of the public DSA (Annex I) indicates that while public debt remains sustainable, risks are elevated. The program aims to put debt on a declining path by the end of the program period through a reduction of the deficit to 3.5 percent of GDP in 2016 and further in 2017 and beyond.

21. Adjustment will rely on both revenue measures and expenditure restraint. Given the desirability of protecting social spending and growth-enhancing capital outlays, staff argued that adjustment should focus on higher revenues. Staff expressed regret with measures that are expected to reduce revenues (e.g., turnover tax rate reduction/VAT threshold increase), recognizing that some were required by EEU accession (e.g., extension of the payment date for VAT collections for EEU imports). For 2016, staff urged that measures be taken to raise excise tax rates, eliminate exemptions, and improve fairness by strengthening coverage of high-wealth individuals. The authorities expressed concern about increasing taxes given weak activity, but they accepted the importance of making broad tax policy changes to enhance revenue and improve efficiency and equity in the context of a new tax code. They argued for an expenditure-led consolidation in 2016, focusing on cuts in non-priority current spending. It was agreed that:

- On **revenues**, specific excise rates on gasoline, diesel, vodka, and cigarettes will be increased, and a new excise on compressed natural gas will be introduced. Revenue administration will be strengthened to address underreporting of turnover by both large taxpayers and SMEs.

- On **expenditures**, the wage bill will be kept broadly unchanged in nominal terms and cuts will be made in spending on goods and services. The authorities will protect capital and social spending, while the interest bill will increase. Staff welcomed the authorities' commitment to provide funding in 2016 to support a new pension reform action plan, to compensate the poor for higher electricity tariffs, and to bring a "lifeline" gas subsidy into the budget.

- In light of **uncertainty and downside risks**, the government stands ready to introduce revenue administration or spending measures, including making use of legal provisions to limit spending commitments to 90 percent of budgeted amounts, either in targeted areas or across the board.[12] It was agreed that capital and social spending should be protected, recognizing that most capital spending is linked to specific financing sources.

22. The new tax code provides an opportunity to address shortcomings in the tax system and to increase funding for growth-enhancing capital and social spending. By revisiting the level and structure of income taxes, eliminating exemptions and tax gaps, and strengthening coverage of HWIs and large companies, the new code should aim to support growth, promote equity, and reduce compliance costs. The reform should lead to higher revenues to support

[12] Tax rate increases require a six-month period of advance notice according to the legislation and are therefore less effective as an immediate contingency response.

consolidation and higher capital and social spending. The new tax code envisages a shift to greater taxation of consumption and a reduction of tax expenditures by reducing VAT and income tax exemptions and incentives. The tax effort also envisages gradual increases of excise taxes to bring them in line with EEU countries. Staff and the authorities agreed that some of the tax changes are sensitive and may require phased transition. The draft code is now open for public consultations. It falls short in some key areas (e.g., strengthening the personal income tax, removal of key exemptions) and will benefit from an IMF review and recommendations from the World Bank and other stakeholders. A final code will be submitted to parliament by March 2016 (new SB). Early adoption of a strong tax package will give assurance that the deficit will improve over the medium term.

Structural Reforms

23. The authorities remain committed to improving the business climate and enhancing regional and global integration. Staff and the authorities agreed that with prospects for weak growth, bolder reforms are needed to strengthen competition, competitiveness, and regional integration. Stepped-up public and private investment is critical. Staff welcomes ongoing reforms to improve bankruptcy, collateral, judiciary, and dispute resolution processes, continue deregulation, enhance transparency, and strengthen energy sector finances. The authorities' 2015 Doing Business Action Plan targets electricity connections, trading across borders, contract enforcement, and construction permits. Another action plan aims to boost competitiveness of SMEs. The authorities have refocused the regulatory guillotine program to maximize cost reductions in tax and customs administration, patents, and government processes. As part of the 'Open Skies' policy in aviation, the authorities are pursuing a Common Aviation Area Agreement with the EU. They are also discussing a new framework agreement with the EU, building on discussions on the free trade and association agreement that did not go forward when Armenia joined the EEU.

Box 1. Prior Actions and Structural Benchmarks

The agreed policy package for the Review includes two prior actions and five new SBs. The prior actions relate to approval of excise tax increases and a new excise tax on compressed natural gas (CNG) and a limit on CBA FX intervention (MEFP Table 2). The tax action demonstrates the authorities' willingness to take tax actions to address important gaps (CNG) and raise revenues. The limit on FX market intervention aims to demonstrate a commitment to a flexible ER and sustaining reserve buffers and is a corrective action for missed targets. The new structural benchmarks (MEFP Table 4) address the key areas of tax reforms and revenue gains and electricity sector finances. These will help underpin fiscal and debt sustainability. Other SBs are aimed to strengthen transparency and risk identification and management around budget lending; these also underpin fiscal sustainability and serve as corrective action for the missed fiscal targets.

24. Further reforms aim to ensure sound energy sector finances. In recent years, the privately-owned electricity distributor ENA accumulated short-term debts to local banks and state generation and transmission companies. This was caused, in part, by insufficient tariff adjustments at a time of higher-than-planned generation costs in 2014. In response, the authorities are beginning implementation of a financial rehabilitation plan in line with World Bank recommendations (new SB). As a first step, in June, the Public Sector Regulatory Commission (PSRC) approved a 16 percent increase of electricity tariffs from August to accelerate recovery of past losses (box). Under the plan, short-term debts are expected to be refinanced, while a new tariff-setting mechanism will be put in place to more closely link tariffs to changes in generation costs.

C. Other program issues

25. External financing needs have increased with deteriorating conditions. The financing gap for 2015–17 is now estimated at $385 million, significantly higher than $131 million at the time of the program request. Fund financing will cover part of the gap ($85 million); $300 million of concessional support from the Eurasian Fund for Stability and Development will cover the remainder. The program is fully financed. There may be delays in disbursement of World Bank budget support expected in 2015; this could be covered by use of government deposits and/or some increase of domestic debt issuance.

Box 2. Electricity Tariff Increase

Background. The June PSRC approval of electricity tariff increases of 16 percent was met by protests, and the application of the higher tariffs was suspended. The government agreed to cover the difference between old and new tariffs for households and SMEs from a non-budgetary source—sale of a hydro facility by the state Vorotan Cascade Company (VCC). The subsidy cost will be split with the new owner of ENA, with the government's share to be limited to $12 million (0.1 percent of GDP). The tariff differential is expected to expire in August 2016. The authorities also launched two audits, one of the regulatory process, to determine whether the tariff hike was well-founded, and one of ENA, to assess financial and operational performance. The regulatory audit has confirmed the rate hike. ENA is being sold by its parent, the Russian firm RAO UES, to an Armenian businessman. VCC also transferred $15 million to extinguish wage arrears of the Nairit rubber factory.

Program implications. The electricity subsidy and wage arrears payment are covered by the program fiscal deficit PC target. The subsidy and arrears payment do not technically violate the PC on absorbing losses or liabilities, as the TMU definition did not extend to extrabudgetary funding sources. This definition has been extended and tightened. Staff recognized the difficult situation created by the protests and welcomed the audits as a way to increase transparency and inform the next steps in the sector. Staff also urged the authorities to try to recoup the funding provided to Nairit via the bankruptcy process.

26. Staff has become aware of two multiple currency practices (MCPs), one introduced in 2007 and the other in 2015. Following the conclusion of the First Review, staff learned that the MOF and CBA settle some budgetary transactions at an agreed accounting exchange rate (ER) under a framework agreement. This practice was introduced in 2007 to provide stability to the fiscal accounts. While staff was aware of the use of a specific ER for accounting purposes in the annual state budget, it did not fully understand how the rate was applied, until recent ER changes and the March Eurobond led the authorities to consult staff. Staff considers that the practice gives rise to an

MCP subject to IMF jurisdiction. However, as the practice was introduced more than four years ago, it has no program implications for the current arrangement, and the misreporting framework (in respect of the predecessor arrangement) does not apply. Approval of the retention of the MCP by the Board is not required for completion of the review. A second MCP emerged in March 2015 when the authorities amended the framework agreement that month to provide for a new rate (a March rate) for the conversion of funds to make a September Eurobond coupon payment. This constituted a new MCP, as no explicit provision was made to ensure that the September FX purchases did not deviate from the prevailing ER by more than 2 percent, thereby leading to a non-observance of the standard continuous PC on the non-introduction of MCPs. The authorities are requesting a waiver of nonobservance in respect of the 2015 MCP on the ground that the deviation was temporary (the September purchase was a one-time occurrence) and, following the transaction, the MCP has ceased to exist.

27. The authorities are requesting waivers of nonobservance for the missed June 2015 PCs and the continuous PC. They are requesting waivers for nonobservance of June 2015 PCs on NDA, NIR, fiscal balance, and of the continuous PC on non-introduction or modification of MCPs. Staff also reached understandings with the authorities on the establishment of a new PC on budgetary domestic lending to prevent recurrence of non-budgeted lending. The authorities are also requesting a rephasing of remaining purchases, so that there will be three remaining reviews, with proposed access of SDR 15.65 million for two reviews and SDR 15.69 for the final review. The arrangement would expire as planned in May 2017.

STAFF APPRAISAL

28. A weaker-than-expected external environment has affected domestic conditions, and together with deviations from program policies, performance under the program. Weaker conditions in Russia, lower commodity prices, slower growth in emerging markets, and global and regional currency movements have translated into FX pressures and lower remittances, fiscal revenues, and banking sector profits. Program performance was also affected: there have been delays in concluding discussions on the Second Review, and all June PCs and one continuous PC were missed. Deviations from program policies included heavy FX intervention, larger-than-expected budget lending, policy changes that affected VAT revenues, and difficulties in introducing electricity tariff and excise tax increases. More broadly, achieving key program objectives—macroeconomic stabilization, reduction of vulnerabilities, and implementation of structural reforms to support Armenia's transition to a dynamic emerging market economy—has lagged.

29. At the same time, the authorities' response helped mitigate the initial impact of the shocks, and a comprehensive set of measures going forward should bring the program back on track. The tightening of monetary conditions and FX intervention in late 2014 and early 2015 stabilized the FX market and inflation, but at the cost of lower reserves and weaker intermediation. Improvement in budget implementation has helped support activity, and swift action to secure external funding strengthened short-term buffers. Weaknesses in policy implementation are being addressed. With adverse conditions likely to persist, a comprehensive response going forward, along with more effective communications, will help maintain stability, reduce vulnerabilities, ensure debt sustainability, and support recovery.

30. The CBA should continue to normalize monetary conditions in the context of its inflation-targeting framework. Conditions remain tighter than a year ago, which in the context of the weaker external environment is placing pressure on activity. Further normalization will help support a resumption of bank lending and growth. Calibrating the pace of normalization is challenging: an unduly fast pace could trigger FX and inflationary pressures, while a slow pace restrains activity and possibly signals commitment to a particular ER. So far, the CBA has tied the pace to inflationary prospects and normalization of the FX market. Going forward, the premium should be on avoiding constraints to intermediation and growth.

31. ER policy should continue to limit intervention, sustain and strengthen buffers, and enhance communications. The high degree of dollarization and the current account deficit of 5 percent of GDP call for maintaining sufficient reserve buffers and facilitating adjustment. This, in turn, calls for limited intervention, greater ER flexibility, and readiness for potentially adverse banking developments. Anxiousness in the market continues, as shown by pressures in August. Large interventions in response to such pressures have been costly and risk sending confusing signals about the monetary and exchange rate framework. Stepped-up and continuous communication with the public and markets is needed. Given the December 2014 adjustment of the ER, and the narrowing of the current account deficit, the dram does not appear to be overvalued at the moment. Yet, the sustainability of the external adjustment is not yet fully certain, and it will be important for the CBA to avoid leaning against the wind. If FX market pressures reemerge and persist, adjustment of the dram would be needed. Monetary policy may need to be tightened, but not to an extent that would suggest efforts to support a particular ER level. While reserves remain above some adequacy benchmarks, they are below metrics for a non-floating ER regime; the high degree of dollarization also suggests that reserves may need to be higher.

32. The increase of bank capital is rightly being complemented by efforts to strengthen crisis preparedness and management. Although the banking system has high capital adequacy ratios, the authorities have taken additional measures, including capital requests to address the anticipated impact of the recent shocks and a six-fold increase of capital requirements, to increase the system's robustness. These measures are being complemented by a stronger crisis preparedness and management framework to ensure that the CBA has the tools needed to avoid or address problems. The CBA and the government should refrain from providing financial support for mergers or acquisitions. Divestiture by the CBA from existing holdings, like PanArmenian Bank, is welcome.

33. The authorities' commitment to fiscal consolidation and debt sustainability is welcome, along with a greater focus on revenue gains. The stimulus in 2015 is appropriate to address the initial impact of the shock, but the authorities should stand ready to respond quickly if revenue risks materialize. They should also ensure that the various budgetary lending channels are well coordinated and monitored and refrain from further large loans. With debt on the rise, consolidation is needed from next year. It should rely mainly on revenues, given the need to protect and increase capital and social spending to support medium-term growth and the vulnerable. The new tax code provides a major opportunity to broaden the tax base by eliminating exemptions and addressing gaps and thereby to support both consolidation and increases in growth-enhancing spending. It is essential that this opportunity is not missed. The draft tax code approved by cabinet in October is a good start, but needs to be significantly improved through the public consultation process. Strengthening collections from HWIs and addressing important gaps and exemptions (e.g., agriculture) should be an important element of the tax reform.

34. Structural reforms—including improved energy sector finances—remain critical to reduce vulnerabilities and support medium-term growth. The authorities' efforts to further improve competition and transparency are welcome, as are business environment improvements, including collateral and bankruptcy reforms, further regulatory streamlining, the Doing Business and SME action plans, and further civil aviation reforms. Membership in the EEU and a new framework agreement with the EU should boost investment and growth through greater regional integration. Special attention is needed to the energy sector, especially the implementation of a comprehensive financial rehabilitation plan in cooperation with the World Bank. Energy sector firms must be commercially managed and avoid non-core activities, while the tariff setting mechanism should be adjusted to avoid relatively long periods of losses. The authorities should discontinue the practice of making public payments on behalf of utilities and other companies and absorbing liabilities and losses. On the positive side, the authorities were able to secure concessional financing to extend the life of the Metsamor nuclear power plant, and Nairit—a long-time drain on public finances—has entered bankruptcy.

35. Staff supports completion of the review and the authorities' request for a purchase in an amount the equivalent of SDR 11.74 million. Risks to the program are significant, but manageable, and Armenia's repayment capacity and track record remain satisfactory. Continued policy and implementation weaknesses are an important downside risk, but the authorities are committed to strengthening performance. Staff supports the request for waiver for nonobservance of the continuous PC on introduction or modification of MCPs and the end-June PCs. Staff also supports the authorities request to rephase the remaining purchases under the program. The authorities' corrective actions and their commitment to policy measures to strengthen implementation will help achieve the objectives of the program. Remaining engaged and providing a clear policy anchor is important, and the agreed measures should help achieve the program objectives. The authorities are expected catch up with their reform agenda within the existing program timeline.

Table 1. Armenia: Selected Economic and Financial Indicators, 2010–17

	2010	2011	2012	2013	2014		2015		2016	2017
	Act.	Act.	Act.	Act.	EBS/14/148 1/	Prel.	EBS/14/148 1/	Proj.	Proj.	Proj.
National income and prices:										
Real GDP (percent change)	2.2	4.7	7.1	3.5	2.6	3.4	3.3	2.5	2.2	2.8
Gross domestic product (in billions of drams) 2/	3,460	3,778	4,266	4,556	4,528	4,843	4,867	5,122	5,443	5,816
Gross domestic product (in millions of U.S. dollars)	9,260	10,142	10,619	11,121	10,969	11,644	11,278	10,607	10,672	11,074
Gross domestic product per capita (in U.S. dollars)	3,128	3,426	3,576	3,732	3,674	3,901	3,771	3,547	3,568	3,703
CPI (period average; percent change)	7.3	7.7	2.5	5.8	2.2	3.0	3.8	4.3	3.4	4.0
CPI (end of period; percent change)	8.5	4.7	3.2	5.6	2.9	4.6	3.6	3.4	4.0	4.0
GDP deflator (percent change) 2/	7.8	4.3	5.4	3.1	3.3	2.8	4.0	3.2	4.0	4.0
Poverty rate (in percent)	35.8	35.0	32.4	32.0	…	…	…	…	…	
Investment and saving (in percent of GDP)										
Investment	29.4	27.0	24.1	22.6	22.0	21.1	22.6	18.9	19.5	20.3
National savings	15.8	16.6	14.1	15.0	14.0	13.8	15.3	14.0	13.7	14.3
Money and credit (end of period)										
Reserve money (percent change)	-0.8	32.3	1.9	29.9	3.1	-0.1	9.3	4.9	4.8	6.7
Broad money (percent change)	10.6	23.6	19.6	15.2	11.5	8.9	11.0	6.8	6.3	6.8
Velocity of broad money (end of period)	3.8	3.4	3.2	2.9	…	2.9	…	2.8	2.8	2.8
Commercial banks' 3-month lending rate (in percent)	17.7	20.7	18.5	18.3	…	18.3	…	…	…	…
Central government operations (in percent of GDP)										
Revenue and grants	21.2	22.1	20.9	22.2	23.6	22.0	23.8	21.5	21.2	21.8
Of which: tax revenue 3/	16.4	16.7	17.0	21.0	22.7	21.0	22.5	20.1	20.0	20.6
Expenditure 4/	26.2	25.0	22.4	23.8	25.1	23.9	26.1	25.4	24.7	24.3
Overall balance on a cash basis	-4.6	-2.8	-1.4	-1.0	-1.5	-2.1	-2.3	-3.9	-3.5	-2.5
Public and publicly-guaranteed debt (in percent of GDP)	39.7	42.0	41.2	40.8	43.9	43.1	44.8	48.2	50.6	51.6
Share of foreign currency debt (in percent)	87.4	86.8	85.8	85.2	85.3	86.1	84.9	88.5	87.7	86.7
External sector										
Exports of goods and services (in millions of U.S. dollars)	2,211	2,742	2,918	3,156	2,914	3,319	3,089	3,226	3,215	3,279
Imports of goods and services (in millions of U.S. dollars)	-4,537	-4,918	-5,131	-5,365	-5,050	-5,468	-5,199	-4,634	-4,693	-4,796
Exports of goods and services (percent change)	41.8	24.0	6.4	8.2	6.6	5.2	6.0	-2.8	-0.3	2.0
Imports of goods and services (percent change)	15.6	8.4	4.3	4.6	2.3	1.9	3.0	-15.3	1.3	2.2
Current account balance (in percent of GDP)	-13.6	-10.4	-10.0	-7.6	-8.1	-7.3	-7.3	-4.9	-5.8	-6.0
FDI (net, in millions of U.S. dollars) 5/	521	437	481	508	361	388	372	334	438	448
Debt service ratio (in percent of exp. of goods and serv.) 6/	4.1	3.7	8.2	27.9	9.8	8.4	5.9	5.8	6.6	7.6
Gross international reserves (in millions of U.S. dollars)	1,866	1,869	1,799	2,253	2,025	1,489	1,989	1,712	1,779	1,927
Import cover 7/	4.6	4.4	4.0	4.9	4.7	3.9	4.4	4.4	4.5	4.7
Nominal effective exchange rate (percent change) 8/	-2.6	-2.8	-2.4	-0.9	…	-1.5	…	…	…	…
Real effective exchange rate (percent change) 8/	2.1	0.1	-3.3	1.2	…	-0.3	…	…	…	…
End-of-period exchange rate (dram per U.S. dollar)	363	386	403.6	405.6	…	475.0	…	…	…	…
Average exchange rate (dram per U.S. dollar)	374	373	401.8	409.6	…	415.9	…	…	…	…
Memorandum item:										
Population (in millions)	3.0	3.0	3.0	3.0	…	3.0	…	…	…	…

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ Staff Report for the First Review and 2014 Article IV Consultation.

2/ In the first quarter of 2015 the authorities started calculating GDP using the SNA 2008 methodology. They have revised GDP series from 2012 on, but pre-2012 series remain calculated using the SNA 1993 methodology. The Staff Report for the First Review and 2014 Consultation was calculated using the pre-revision series. The increase in the GDP deflator in 2012 is due to this methodological change. Without this methodological change, the GDP deflator in2012 is -1.2 percent.

3/ In 2013, tax revenue includes social contribution.

4/ In 2013 includes 1.5 percent of GDP related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom, and the transfer (expenditure) of the same amount from the government to ArmRusGazprom to liquidate liabilities. A surplus of 0.6 percent of GDP is obtained when this transaction is excluded.

5/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.

6/ Based on public and publicly-guaranteed debt.

7/ Gross international reserves in months of next year's imports of goods and services, including the SDR holdings.

8/ A positive sign denotes appreciation.

Table 2. Armenia: Balance of Payments, 2010–20

(In millions of U.S. dollars, unless otherwise indicated)

	2010	2011	2012	2013	2014		2015		2016	2017	2018	2019	2020
	Act.	Act.	Act.	Prel.	EBS/14/148	Prel.	EBS/14/148	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account	-1,261	-1,059	-1,058	-845	-884	-849	-821	-520	-616	-664	-688	-710	-724
Trade balance	-2,066	-2,110	-2,112	-2,092	-2,163	-2,055	-2,164	-1,384	-1,438	-1,477	-1,507	-1,531	-1,565
Exports, fob	1,197	1,432	1,516	1,636	1,640	1,698	1,752	1,622	1,643	1,675	1,723	1,782	1,852
Imports, fob 1/	-3,263	-3,541	-3,628	-3,728	-3,804	-3,754	-3,915	-3,005	-3,081	-3,152	-3,230	-3,313	-3,417
Services (net)	-261	-66	-102	-117	27	-93	54	-24	-40	-41	-58	-76	-69
Credits	1,013	1,311	1,402	1,520	1,273	1,621	1,337	1,605	1,572	1,604	1,636	1,669	1,719
Debits	-1,274	-1,376	-1,504	-1,637	-1,246	-1,714	-1,283	-1,628	-1,612	-1,644	-1,694	-1,745	-1,788
Income (net) 2/	458	360	423	539	472	556	487	307	269	232	237	234	222
Transfers (net)	607	757	733	825	780	744	802	581	593	621	640	664	689
Private	513	584	625	704	718	641	754	461	471	485	499	519	540
Official	94	172	108	121	62	103	48	120	122	136	140	144	149
Capital and financial account	1,117	1,007	848	1,789	764	260	774	649	574	743	784	845	830
Capital transfers (net)	99	95	108	84	68	70	80	66	77	66	69	70	71
Foreign direct investment (net) 2/	521	437	481	508	361	388	372	334	438	448	462	478	495
Portfolio investment (net)	18	-8	1	-9	-1	-43	-10	-26	-35	-31	-33	-32	-32
Public sector borrowing (net)	168	151	225	376	201	216	143	479	200	238	187	229	167
Disbursements	193	180	255	914	237	257	199	740	271	323	284	343	785
Amortization	-25	-28	-30	-537	-36	-41	-56	-260	-71	-85	-97	-113	-619
Other capital (net)	310	332	34	830	135	-371	188	-204	-108	21	100	100	130
Errors and omissions	-156	-37	191	0	0	-66	0	0	0	0	0	0	0
Overall balance	-298	-88	-18	644	-120	-655	-48	129	-42	79	96	135	105
Financing	298	88	18	-644	102	655	11	-246	-104	-202	-96	-135	-105
Gross international reserves (increase: -)	138	-4	70	-454	228	764	36	-222	-67	-148	-30	-57	-21
Use of Fund credit, net	160	92	-52	-190	-126	-109	-25	-24	-37	-54	-67	-79	-84
Purchases/disbursements	181	114	103	84	18	34	...	...	...	...	...	...	...
Repurchases/repayments	-22	-23	-155	-274	-144	-143	-25	-24	-37	-54	-67	-79	-84
Financing gap	0	0	0	0	18	0	36	117	146	123	0	0	0
IMF EFF	0	0	0	0	18	0	36	17	46	23	...	...	...
Other 3/	0	0	0	0	0	0	0	100	100	100	...	...	...
Memorandum items:													
Current account (in percent of GDP)	-13.6	-10.4	-10.0	-7.6	-8.1	-7.3	-7.3	-4.9	-5.8	-6.0	-5.9	-5.8	-5.6
Trade balance (in percent of GDP)	-22.3	-20.8	-19.9	-18.8	-19.7	-17.7	-19.2	-13.0	-13.5	-13.3	-13.0	-12.5	-12.1
Gross international reserves (end of period)	1,866	1,869	1,799	2,253	2,025	1,489	1,989	1,712	1,779	1,927	1,956	2,013	2,034
In months of next year's imports	4.6	4.4	4.0	4.9	4.7	3.9	4.4	4.4	4.5	4.7	4.6	4.6	4.7
Merchandise export growth, percent change	54.8	19.5	5.9	7.9	0.3	3.8	6.8	-4.5	1.3	1.9	2.9	3.4	3.9
Merchandise import growth, percent change	14.0	8.5	2.4	2.8	2.0	0.7	2.9	-19.9	2.5	2.3	2.5	2.6	3.1
Non-gas merchandise imports growth, percent cha	11.2	7.3	0.5	5.7	4.2	1.0	2.5	-18.2	2.6	2.4	2.5	2.6	3.2
Nominal external debt	6,145	7,252	7,456	8,750	8,840	8,262	9,229	8,539	8,595	8,801	9,022	9,276	9,493
o.w. public external debt	3,299	3,568	3,738	3,902	4,054	3,785	4,255	4,266	4,430	4,615	4,736	4,890	4,978
Nominal external debt stock (in percent of GDP)	66.4	71.5	70.2	78.7	80.6	71.0	81.8	80.5	80.5	79.5	77.6	75.6	73.4
External public debt-to-exports ratio (in percent)	149.2	130.1	128.1	123.6	139.1	114.1	137.7	132.2	137.8	140.7	141.0	141.7	139.4
External public debt service (in percent of exports)	4.1	3.7	8.2	27.9	9.8	8.4	5.9	5.8	6.6	7.6	8.3	9.1	23.6

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ From 2014 on, imports of gas are calculated at the (lower) price of $189 per thousand cubic meter. In addition to reducing projected gas imports in 2014, this change also implies lower FDI (lower intercompany lending between parent and subsidiary)

2/ In 2013, a credit for $155 million is registered in FDI to reflect the acquisition by Gazprom of 20 percent of the shares of ArmRusGazprom, while an offseting debit is registered in other capital (net) to reflect the corresponding reduction in liabilities of the latter with the former.

3/ Prospective financing from the Eurasian Fund for Stability and Development.

Table 3. Armenia: Monetary Accounts, 2010–16
(in billions of drams, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015				2016			
	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Proj.		Proj.			
					Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Central Bank of Armenia													
Net foreign assets	423.8	465.0	467.2	655.8	437.4	459.8	473.4	449.6	496.6	469.1	465.9	498.5	489.2
Net international reserves	500.6	521.2	538.7	768.7	569.2	591.7	607.8	603.4	651.3	629.1	627.0	668.3	657.2
Other	-76.9	-56.3	-71.5	-112.9	-131.8	-131.9	-134.4	-153.9	-154.7	-160.1	-161.2	-169.8	-167.9
Net domestic assets	83.8	206.3	216.6	232.2	449.4	332.2	344.6	433.3	433.5	396.6	437.7	410.9	486.0
Claims on general government (net)	-95.6	-66.7	-93.3	-175.9	-102.1	-203.2	-161.0	-130.5	-137.3	-132.1	-124.8	-140.2	-119.4
Of which: central government (net)	-76.7	-54.2	-80.5	-160.1	-83.9	-180.2	-138.9	-108.4	-115.2	-110.0	-102.8	-118.1	-97.3
Claims on banks	57.4	137.0	152.9	174.0	312.5	281.3	252.5	292.0	287.9	259.2	265.3	274.0	272.1
CBA bills 1/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other items (net)	122.0	136.0	157.0	234.1	239.0	254.0	253.1	271.8	282.9	269.5	297.2	277.2	333.3
Reserve money	507.6	671.3	683.8	888.1	886.8	792.0	818.0	882.9	930.1	865.6	903.6	909.4	975.2
Currency issue	348.2	398.8	440.1	446.8	412.3	345.9	375.1	379.9	427.0	352.2	382.9	392.0	444.5
Deposits	159.4	272.5	243.7	441.2	474.4	446.1	442.9	503.0	503.2	513.5	520.7	517.4	530.7
Deposits in drams	61.4	169.9	157.7	202.4	337.7	335.0	317.8	310.4	327.8	336.4	341.8	336.8	348.3
Deposits in foreign currency	98.0	102.6	86.0	238.8	136.7	111.0	125.1	192.6	175.3	177.1	178.8	180.6	182.4
Banking system													
Net foreign assets	193.8	31.9	-124.2	-58.8	-373.1	-297.8	-240.1	-327.4	-278.1	-305.6	-308.8	-276.2	-285.5
Net domestic assets	717.4	1,094.7	1,471.2	1,610.9	2,062.8	1,935.9	1,962.8	2,045.9	2,082.6	2,087.8	2,144.3	2,098.3	2,202.8
Claims on government (net)	-50.9	-1.8	17.0	-9.6	79.5	-9.8	23.9	60.4	61.5	75.1	90.8	83.8	113.1
Of which: claims on central government (net)	-32.0	10.7	29.8	6.1	97.8	13.1	45.9	82.4	83.6	97.2	112.9	105.9	135.1
Claims on rest of the economy	922.9	1,251.2	1,587.9	1,781.7	2,147.3	2,072.2	2,057.1	2,108.7	2,144.3	2,140.9	2,181.7	2,147.7	2,223.0
Other items (net)	-154.5	-154.7	-133.7	-161.2	-163.9	-126.5	-118.2	-123.2	-123.2	-128.2	-128.2	-133.2	-133.2
Broad money	911.2	1,126.6	1,347.0	1,552.1	1,689.8	1,638.1	1,722.7	1,718.5	1,804.5	1,782.1	1,835.4	1,822.1	1,917.3
Currency in circulation	304.5	349.6	384.3	384.9	349.2	297.8	325.7	330.0	369.3	309.5	339.0	347.6	392.5
Deposits	606.7	777.0	962.7	1,167.2	1,340.6	1,340.3	1,397.0	1,388.5	1,435.1	1,472.6	1,496.4	1,474.4	1,524.9
Domestic currency	216.7	306.5	355.9	470.2	483.8	495.2	515.6	487.0	511.7	514.7	536.7	513.0	543.7
Foreign currency	389.9	470.5	606.8	697.0	856.7	845.1	881.4	901.5	923.4	957.9	959.7	961.4	981.1
Memorandum items:													
Exchange rate (in drams per U.S. dollar, end of period)	363.4	385.8	403.6	405.6	475.0	471.1	480.8	...	...	...	...	...	...
NIR, program definition, at program exchange rates (USD millions)	892	794	830	1,068	796	902	913	832	992	954	955	1,079	1,050
12-month change in reserve money (in percent)	-0.8	32.3	1.9	29.9	-0.1	1.6	14.7	22.8	4.9	9.3	10.5	3.0	4.8
12-month change in broad money (in percent)	10.6	23.6	19.6	15.2	8.9	6.1	7.7	6.7	6.8	8.8	6.5	6.0	6.3
12-month change in dram broad money (in percent)	15.0	25.9	12.8	15.5	-2.6	-1.0	-1.0	-7.4	5.8	3.9	4.1	5.3	6.3
12-month change in private sector credit (in percent)	26.7	35.6	26.9	12.2	20.5	14.0	9.6	9.9	-0.1	3.3	6.1	1.8	3.7
Velocity of broad money (end of period)	3.8	3.4	3.2	2.9	2.9	3.0	2.9	2.9	2.8	2.9	2.9	2.9	2.8
Money multiplier	1.8	1.7	2.0	1.7	1.9	2.1	2.1	1.9	1.9	2.1	2.0	2.0	2.0
Dollarization in bank deposits 2/	64.3	60.6	63.0	59.7	63.9	63.1	63.1	64.9	64.3	65.0	64.1	65.2	64.3
Dollarization in broad money 3/	42.8	41.8	45.0	44.9	50.7	51.6	51.2	52.5	51.2	53.7	52.3	52.8	51.2
Currency in circulation in percent of deposits	50.2	45.0	39.9	33.0	26.0	22.2	23.3	23.8	25.7	21.0	22.7	23.6	25.7
Stock of foreign currency deposits (in millions of U.S. dollars) 4/	1,013	1,222	1,576	1,700	2,090	2,061	2,150	2,199	2,252	2,336	2,341	2,345	2,393
Banking system financing of the central government (cumulative) 5/	79.6	42.7	19.1	-23.7	91.6	-84.6	-51.8	-15.3	-14.2	13.6	29.3	22.3	51.5
Banks' deposits at CBA to deposits in banking system (in percent)	26.3	35.1	25.3	37.8	35.4	33.3	31.7	36.2	35.1	34.9	34.8	35.1	34.8

Sources: Central Bank of Armenia; and Fund staff estimates and projections.

1/ Following the agreement between the CBA and the Ministry of Finance, the issue of new CBA bills was terminated in 2008.

2/ Ratio of foreign currency deposits to total deposits (in percent).

3/ Ratio of foreign currency deposits to broad money (in percent).

4/ At the program exchange rate.

5/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.

Table 4. Armenia: Financial Soundness Indicators for the Banking Sector, 2010–15
(in percent, unless otherwise indicated)

	2010	2011	2012	2013	2014				2015	
	Dec.	Dec.	Dec.	Dec.	Mar.	Jun.	Sep	Dec.	Mar.	Jun.
Capital adequacy										
Total regulatory capital to risk-weighted assets	22.2	18.3	16.8	16.7	16.4	16.2	16.3	14.5	15.1	15.4
Capital (net worth) to assets	20.4	17.2	15.9	15.3	15.7	16.0	16.1	14.0	14.4	14.6
Asset composition										
Sectoral distribution of loans (in billions of drams)										
Industry (excluding energy sector)	156.7	178.6	250.3	222.7	218.0	239.5	236.3	266.3	245.9	245.4
Energy sector	47.2	77.5	74.9	95.4	95.1	92.1	92.9	112.4	103.7	94.0
Agriculture	52.4	80.7	101.4	118.2	129.6	137.3	135.8	150.2	160.7	162.7
Construction	74.8	96.0	100.1	109.4	113.3	109.9	114.8	124.2	114.7	115.1
Transport and communication	25.7	50.9	48.3	54.0	50.0	49.0	46.4	52.0	52.6	54.9
Trade/commerce	184.8	275.7	321.0	352.3	344.6	343.6	357.9	386.3	363.3	352.2
Consumer credits				365.6	390.7	403.0	415.2	451.5	436.4	422.9
Mortgage loans				143.2	145.1	150.8	154.6	172.4	169.4	170.8
Sectoral distribution of loans to total loans (percent of total)										
Industry (excluding energy sector)	17.7	14.0	15.5	12.2	11.6	12.5	11.9	12.0	11.6	11.8
Energy sector	5.3	6.1	4.6	5.2	5.1	4.8	4.7	5.1	4.9	4.5
Agriculture	5.9	6.3	6.3	6.5	6.9	7.1	6.8	6.8	7.6	7.8
Construction	8.4	7.5	6.2	6.0	6.0	5.7	5.8	5.6	5.4	5.5
Transport and communication	2.9	4.0	3.0	3.0	2.7	2.6	2.3	2.3	2.5	2.6
Trade/commerce	20.9	21.6	19.9	19.3	18.4	17.9	18.0	17.4	17.2	16.9
Consumer credits				20.1	20.8	21.0	20.9	20.3	20.7	20.3
Mortgage loans				7.9	7.7	7.8	7.8	7.8	8.0	8.2
Foreign exchange loans to total loans	58.0	61.2	64.7	63.8	64.2	64.1	63.8	64.7	67.7	67.1
Asset quality										
Nonperforming loans (in billions of drams)	28.6	43.7	58.4	79.7	108.5	113.2	125.9	149.9	170.7	187.6
Watch (up to 90 days past due)	11.3	18.8	26.5	41.4	66.4	58.4	63.0	72.7	77.7	85.0
Substandard (91-180 days past due)	11.3	15.6	19.0	19.5	27.6	36.6	36.0	44.3	56.1	61.3
Doubtful (181-270 days past due)	6.1	9.3	12.8	18.8	14.4	18.3	26.9	32.9	36.9	41.2
Loss (>270 days past due)	34.6	45.2	77.4	108.0	119.9	124.4	136.8	173.4	195.3	217.6
Nonperforming loans to gross loans	3.1	3.4	3.6	4.5	5.9	6.0	6.5	6.8	8.1	9.0
Provisions to nonperforming loans	56.7	55.4	55.1	49.5	39.4	41.0	41.5	41.3	39.1	38.1
Spread between highest and lowest rates of interbank borrowing in AMD	4.0	1.5	1.0	2.2	0.5	1.2	0.3	4.0	10.5	3.0
Spread between highest and lowest rates of interbank borrowing in forei	5.0	5.3	9.5	6.3	0.5	1.0	1.8	3.5	0.8	0.0
Earnings and profitability										
ROA (profits to period average assets)	2.2	1.9	1.1	1.4	1.1	1.3	1.1	0.7	-0.5	-0.4
ROE (profits to period average equity)	10.2	9.8	11.5	9.2	6.8	8.0	7.2	4.6	-3.4	-3.1
Interest margin to gross income	43.8	42.0	40.6	37.1	36.2	36.5	36.9	35.7	28.2	29.2
Interest income to gross income	77.0	78.3	80.0	79.1	78.4	78.5	78.5	77.3	78.2	77.9
Noninterest expenses to gross income	39.2	36.4	34.2	33.0	32.1	32.4	32.1	31.7	28.9	29.0
Liquidity										
Liquid assets to total assets	29.5	27.9	25.6	29.1	29.6	27.5	26.7	25.1	24.1	25.2
Liquid assets to total short-term liabilities	131.5	120.8	126.1	142.3	145.6	134.1	133.2	129.4	137.1	138.2
Customer deposits to total (non-interbank) loans	87.2	91.5	92.6	105.6	105.5	101.8	99.3	98.0	99.8	103.1
Foreign exchange liabilities to total liabilities	64.9	63.3	64.9	64.1	65.9	64.6	63.6	63.5	64.1	64.4
Sensitivity to market risk										
Gross open positions in foreign exchange to capital	2.9	3.0	3.8	3.7	2.6	2.9	2.8	14.6	8.6	7.5
Net open position in FX to capital	-0.2	-0.9	1.6	0.1	0.3	0.7	-0.8	-11.1	-4.6	-3.3

Source: Central Bank of Armenia.

Table 5. Armenia: Central Government Operations, 2010–17

(In billions of dram)

	2010	2011	2012	2013	2014		2015			2016	2017
	Act.	Act.	Act.	Act. 2/	EBS/14/148	Prel.	Budg.	EBS/14/148	Proj.	Proj.	Proj.
Total revenue and grants	734.3	834.5	892.6	1011.5	1068.5	1064.6	1155.7	1157.0	1103.8	1156.0	1269.8
Total revenue	706.1	776.6	875.7	1000.7	1057.7	1050.1	1129.6	1129.6	1074.5	1124.3	1247.3
Tax revenues	568.9	629.6	723.4	956.6	1025.9	1018.4		1095.9	1031.1	1087.0	1196.9
VAT	278.1	301.5	340.4	371.7	398.4	401.0		425.7	392.3	407.8	459.1
Profits, simplified and presumptive	99.7	143.8	164.5	167.6	168.5	120.9		150.2	105.5	106.6	119.8
Personal income tax	73.9	81.2	91.7	256.9	284.5	301.1		303.2	313.3	332.9	355.8
Customs duties	29.4	34.7	41.3	44.3	46.9	48.4		52.9	58.1	64.9	71.5
Other	87.8	68.4	85.6	116.1	127.6	147.0		163.9	162.0	174.6	190.7
Social contributions 1/	105.3	123.4	129.1	17.9	4.0	4.8		6.6	9.8	13.4	24.7
Other revenue	31.8	23.6	23.2	26.2	27.8	26.9		27.1	33.6	24.0	25.6
Grants	28.2	57.9	16.9	10.8	10.8	14.5	26.2	27.5	29.3	31.7	22.5
Budget support	5.4	28.4	10.5	6.3	0.0	10.5					
Project grants	22.8	29.5	6.4	4.5	10.8	4.0					
Total expenditure	906.6	943.1	956.3	1084.1	1135.9	1158.4	1269.9	1269.9	1303.4	1346.8	1413.9
Expenses 2/	727.9	788.7	852.4	980.6	1037.1	1048.7	1161.0	1161.0	1186.3	1216.6	1256.2
Wages	187.3	190.5	194.3	215.6	249.7	253.4		291.3	299.3	306.6	310.8
Social Contributions	4.5	4.7	4.8	0.0	0.0	0.0		0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.0	0.0	0.0	0.0	8.0	9.5		13.3	18.6	26.8	49.5
Subsidies 3/	3.4	4.3	4.6	4.9	10.6	8.4		12.2	24.6	15.9	8.2
Interest	30.2	35.2	40.2	46.7	63.4	61.6		73.9	76.3	99.4	101.0
Social allowances and pensions	241.7	255.1	287.4	294.0	344.3	335.0		379.3	380.2	386.6	394.2
Pensions/social security benefits	176.8	186.6	197.5	198.4	223.6	218.1		249.9	249.6	250.3	252.2
Social assistance benefits	64.9	68.5	89.9	95.6	120.7	117.0		129.5	130.6	136.3	142.1
Employer social benefits	0.0	0.0	12.1	0.0	0.0	0.0		0.0	0.0	0.0	0.0
Goods and services	84.2	95.4	132.6	140.9	149.3	112.2		154.9	112.7	72.1	74.4
Grants	66.6	69.2	71.4	78.2	86.9	82.9		100.8	104.7	102.5	105.1
Other expenditure 4/	110.1	134.3	117.1	200.3	124.8	185.6		135.3	169.9	206.7	213.0
Transactions in nonfinancial assets	178.7	154.4	103.9	103.5	98.9	109.7	108.9	108.9	117.1	130.1	157.7
Acquisition of nonfinancial assets 5/	179.2	157.7	106.6	105.0	100.3	111.2		109.7	133.1	130.1	157.7
Disposals of nonfinancial assets	0.5	3.3	2.7	1.6	1.4	1.6		0.7	16.0	0.0	0.0
Overall balance (above-the-line)	-172.3	-108.7	-63.8	-72.6	-67.5	-93.8	-114.1	-112.8	-199.6	-190.7	-144.1
Statistical discrepancy	13.2	2.9	2.1	28.6	0.0	-7.6		0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-159.1	-105.8	-61.6	-43.9	-67.5	-101.4		-112.8	-199.6	-190.7	-144.1
Financing	159.1	105.8	61.6	43.9	67.5	101.4		112.8	199.6	190.7	144.1
Domestic financing	96.5	62.7	6.8	-43.9	44.5	75.7		98.8	-21.6	84.3	23.3
Banking system 6/	95.6	55.1	20.1	-23.7	79.6	91.6		70.5	-14.2	51.5	13.1
CBA	62.1	22.4	-26.3	-79.6	67.0	76.3		38.5	-31.4	17.9	-18.9
Commercial Banks	33.5	32.7	46.4	55.9	12.6	15.4		32.0	17.2	33.6	32.0
Nonbanks	0.9	7.6	-13.2	-20.2	5.8	-16.0		29.1	-4.0	32.8	10.2
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0		0.0	12.6	0.0	0.0
T-Bills/other	5.5	4.3	-24.6	-62.7	-3.2	7.3		8.0	-7.3	8.4	8.0
Promissory note/other	-2.0	0.0	0.0	63.3	0.0	-6.5		0.0	0.0	0.0	0.0
Net lending	-2.6	3.4	11.4	-20.9	9.1	-16.7		21.1	-9.2	24.4	2.2
External financing	62.5	43.0	54.8	87.8	23.0	25.8		14.0	172.9	55.5	68.3
Gross inflow 4/ 7/	105.3	88.9	118.4	373.1	97.8	106.8		85.7	346.3	138.5	169.5
Amortization due	-9.7	-10.8	-27.9	-246.4	-38.6	-38.6		-26.6	-118.7	-36.2	-51.5
Net lending	-33.1	-35.1	-35.6	-38.9	-36.2	-42.4		-45.1	-54.7	-46.8	-49.6
Other financing 8/	...	...	...	0.0	0.0	0.0		0.0	48.3	51.0	52.5
Memorandum items:											
Nominal GDP (in billion of drams)	3,460	3,778	4,266	4,556	4,528	4,843	4,867	4,867	5,122	5,443	5,816
Program balance 9/	-124.4	-137.4	-85.9	-40.4	-94.6	-160.5		143.0	-263.5	-213.2	-191.5
Primary balance 10/	-177.8	-105.1	-47.8	-85.6	-31.2	-91.2		-62.9	-187.2	-113.7	-90.5
Debt-creating fiscal balance 11/	-205.4	-143.7	-99.4	-48.2	-103.7	-136.2		-157.9	-254.3	-237.5	-193.7
Government securities issuance	30.2	30.3	30.8	20.4	...	16.7		...	10.0	42.0	40.0

Sources: Ministry of Finance, Central Bank of Armenia, and Fund staff estimates and projections.

1/ From 2014, social contributions include contributions to the second pillar of the pension system.

2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately. A further reclassification of expenses was made in 2015 whereby some spending on goods and services was classified in other categories.

3/ In 2015 reflects the payment of wage arrears for Nairit and the electricity subsidy to households and SMEs.

4/ In 2013 includes AMD 63 billion related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other expenditure)

5/ Includes acquisition of military equipment.

of the same amount from the government to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit would amount to AMD 43.6 billion, or 1 percent of GDP.

6/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.

7/ Includes IMF budget support in 2011-12.

8/ Prospective EFSD financing ($100 million in 2015-17).

9/ The program balance is measured as below-the-line overall balance minus net lending, except from 2010 to 2011Q1, where project financing is also subtracted.

10/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.

11/ Sum of overall balance (above-the-line) and external net lending. In 2013, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 6. Armenia: Central Government Operations, 2010–17

(In percent of GDP)

	2010	2011	2012	2013	2014		2015			2016	2017
	Act.	Act.	Act.	Act.	EBS/14/148	Prel.	Budg.	EBS/14/148	Proj.	Proj.	Proj.
Total revenue and grants	21.2	22.1	20.9	22.2	23.6	22.0	23.7	23.8	21.5	21.2	21.8
Total revenue	20.4	20.6	20.5	22.0	23.4	21.7	23.2	23.2	21.0	20.7	21.4
Tax revenues	16.4	16.7	17.0	21.0	22.7	21.0		22.5	20.1	20.0	20.6
VAT	8.0	8.0	8.0	8.2	8.8	8.3		8.7	7.7	7.5	7.9
Profits, simplified and presumptive	2.9	3.8	3.9	3.7	3.7	2.5		3.1	2.1	2.0	2.1
Personal income tax	2.1	2.1	2.1	5.6	6.3	6.2		6.2	6.1	6.1	6.1
Customs duties	0.8	0.9	1.0	1.0	1.0	1.0		1.1	1.1	1.2	1.2
Other	2.5	1.8	2.0	2.5	2.8	3.0		3.4	3.2	3.2	3.3
Social contributions 1/	3.0	3.3	3.0	0.4	0.1	0.1		0.1	0.2	0.2	0.4
Other revenue	0.9	0.6	0.5	0.6	0.6	0.6		0.6	0.7	0.4	0.4
Grants	0.8	1.5	0.4	0.2	0.2	0.3	0.5	0.6	0.6	0.6	0.4
Budget support	0.2	0.8	0.2	0.1	0.0	0.2					
Project grants	0.7	0.8	0.2	0.1	0.2	0.1					
Total expenditure	26.2	25.0	22.4	23.8	25.1	23.9	26.1	26.1	25.4	24.7	24.3
Expense 2/	21.0	20.9	20.0	21.5	22.9	21.7	23.9	23.9	23.2	22.4	21.6
Wages	5.4	5.0	4.6	4.7	5.5	5.2		6.0	5.8	5.6	5.3
Social Contributions	0.1	0.1	0.1	0.0	0.0	0.0		0.0	0.0	0.0	0.0
Payments to individual pension accts.	0.0	0.0	0.0	0.0	0.2	0.2		0.3	0.4	0.5	0.9
Subsidies 3/	0.1	0.1	0.1	0.1	0.2	0.2		0.3	0.5	0.3	0.1
Interest	0.9	0.9	0.9	1.0	1.4	1.3		1.5	1.5	1.8	1.7
Social allowances and pensions	7.0	6.8	6.7	6.5	7.6	6.9		7.8	7.4	7.1	6.8
Pensions/social security benefits	5.1	4.9	4.6	4.4	4.9	4.5		5.1	4.9	4.6	4.3
Social assistance benefits	1.9	1.8	2.1	2.1	2.7	2.4		2.7	2.5	2.5	2.4
Employer social benefits	0.0	0.0	0.3	0.0	0.0	0.0		0.0	0.0	0.0	0.0
Goods and services	2.4	2.5	3.1	3.1	3.3	2.3		3.2	2.2	1.3	1.3
Grants	1.9	1.8	1.7	1.7	1.9	1.7		2.1	2.0	1.9	1.8
Other expenditure 4/	3.2	3.6	2.7	4.4	2.8	3.8		2.8	3.3	3.8	3.7
Transactions in nonfinancial assets	5.2	4.1	2.4	2.3	2.2	2.3	2.2	2.2	2.3	2.4	2.7
Acquisition of nonfinancial assets 5/	5.2	4.2	2.5	2.3	2.2	2.3		2.3	2.6	2.4	2.7
Disposals of nonfinancial assets	0.0	0.1	0.1	0.0	0.0	0.0		0.0	0.3	0.0	0.0
Overall balance (above-the-line)	-5.0	-2.9	-1.5	-1.6	-1.5	-1.9	-2.3	-2.3	-3.9	-3.5	-2.5
Statistical discrepancy	0.4	0.1	0.0	0.6	0.0	-0.2		0.0	0.0	0.0	0.0
Overall balance (below-the-line)	-4.6	-2.8	-1.4	-1.0	-1.5	-2.1		-2.3	-3.9	-3.5	-2.5
Financing	4.6	2.8	1.4	1.0	1.5	2.1		2.3	3.9	3.5	2.5
Domestic financing	2.8	1.7	0.2	-1.0	1.0	1.6		2.0	-0.4	1.5	0.4
Banking system 6/	2.8	1.5	0.5	-0.5	1.8	1.9		1.4	-0.3	0.9	0.2
CBA	1.8	0.6	-0.6	-1.7	1.5	1.6		0.8	-0.6	0.3	-0.3
Commercial Banks	1.0	0.9	1.1	1.2	0.3	0.3		0.7	0.3	0.6	0.6
Nonbanks	0.0	0.2	-0.3	-0.4	0.1	-0.3		0.6	-0.1	0.6	0.2
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.2	0.0	0.0
T-Bills/other	0.2	0.1	-0.6	-1.4	-0.1	0.1		0.2	-0.1	0.2	0.1
Promissory note/other	-0.1	0.0	0.0	1.4	0.0	-0.1		0.0	0.0	0.0	0.0
Net lending	-0.1	0.1	0.3	-0.5	0.2	-0.3		0.4	-0.2	0.4	0.0
External financing	1.8	1.1	1.3	1.9	0.5	0.5		0.3	3.4	1.0	1.2
Gross inflow 4/ 7/	3.0	2.4	2.8	8.2	2.2	2.2		1.8	6.8	2.5	2.9
Amortization due	-0.3	-0.3	-0.7	-5.4	-0.9	-0.8		-0.5	-2.3	-0.7	-0.9
Net lending	-1.0	-0.9	-0.8	-0.9	-0.8	-0.9		-0.9	-1.1	-0.9	-0.9
Other financing 8/	...	...	...	0.0	0.0	0.0		0.0	0.9	0.9	0.9
Memorandum items:											
Nominal GDP (in billion of drams)	3,460	3,778	4,266	4,556	4,528	4,843	4,867	4,867	5,122	5,443	5,816
Program balance 9/	-3.6	-3.6	-2.0	-0.9	-2.1	-3.3		2.9	-5.1	-3.9	-3.3
Primary balance 10/	-5.1	-2.8	-1.1	-1.9	-0.7	-1.9		-1.3	-3.7	-2.1	-1.6
Debt-creating fiscal balance 11/	-5.9	-3.8	-2.3	-1.1	-2.3	-2.8		-3.2	-5.0	-4.4	-3.3
Government securities issuance	0.9	0.8	0.7	0.4	...	0.3		...	0.2	0.8	0.7

Sources: Ministry of Finance, Central Bank of Armenia, and Fund staff estimates and projections.

1/ From 2014, social contributions include contributions to the second pillar of the pension system.

2/ Composition of expense reclassified in November 2013 to account for wage bill more accurately. A further reclassification of expenses was made in 2015 whereby some spending on goods and services was classified in other categories.

3/ In 2015 reflects the payment of wage arrears for Nairit and the electricity subsidy to households and SMEs.

4/ In 2013 includes AMD 63 billion related to the acquisition by Gazprom from the government of 20 percent of the shares of ArmRusGazprom (gross inflow), and the transfer (other expenditure)

5/ Includes acquisition of military equipment.

of the same amount from the government to ArmRusGazprom to liquidate liabilities. Excluding this transaction, the deficit would amount to AMD 43.6 billion, or 1 percent of GDP.

6/ Discrepancy between the fiscal and monetary accounts in 2009Q3-Q4, 2010, and 2011 is explained by government lending to the economy through commercial banks.

7/ Includes IMF budget support in 2011-12.

8/ Prospective EFSD financing ($100 million in 2015-17).

9/ The program balance is measured as below-the-line overall balance minus net lending, except from 2010 to 2011Q1, where project financing is also subtracted.

10/ Sum of overall balance (above the line), interest expense, and domestic and external net lending.

11/ Sum of overall balance (above-the-line) and external net lending. In 2013, it excludes the transfer associated to the acquisition of ArmRusGazprom by Gazprom, since it was financed with the sale of the government's shares in the company.

Table 7. Armenia: Medium-Term Macroeconomic Framework, 2010–20
(in percent of GDP, unless otherwise indicated)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
	Act.	Act.	Act.	Act.	Prel.	Projections					
National income and prices											
Real GDP (percent change)	2.2	4.7	7.1	3.5	3.4	2.5	2.2	2.8	3.0	3.5	3.5
Gross domestic product (in millions of U.S. dollars)	9,260	10,142	10,619	11,121	11,644	10,607	10,672	11,074	11,630	12,273	12,939
Gross national income per capita (in U.S. dollars)	3,283	3,548	3,718	3,913	4,087	3,649	3,659	3,780	3,967	4,181	4,399
CPI inflation, period average (percent change)	7.3	7.7	2.5	5.8	3.0	4.3	3.4	4.0	4.0	4.0	4.0
Investment and saving											
Investment	29.4	27.0	24.1	22.6	21.1	18.9	19.5	20.3	20.7	21.3	21.4
Private	24.3	22.9	21.6	20.4	18.8	16.6	17.1	17.6	18.1	18.6	18.6
Public	5.2	4.1	2.4	2.3	2.3	2.3	2.4	2.7	2.6	2.7	2.8
National savings	15.8	16.6	14.1	15.0	13.8	14.0	13.7	14.3	14.8	15.5	15.8
Private	15.6	15.3	13.2	14.4	13.4	15.6	14.8	14.1	14.0	14.6	14.8
Public	0.2	1.2	0.9	0.7	0.3	-1.6	-1.1	0.2	0.8	0.9	1.0
Central government operations											
Revenue and grants	21.2	22.1	20.9	22.2	22.0	21.5	21.2	21.8	22.1	22.1	22.2
Of which: tax revenue	16.4	16.7	17.0	21.0	21.0	20.1	20.0	20.6	20.8	21.0	21.2
grants	0.8	1.5	0.4	0.2	0.3	0.6	0.6	0.4	0.2	0.1	0.0
Expenditure	26.2	25.0	22.4	23.8	23.9	25.4	24.7	24.3	23.9	23.9	24.0
Current expenditure	21.0	20.9	20.0	21.5	21.7	23.2	22.4	21.6	21.3	21.2	21.2
Capital expenditure	5.2	4.1	2.4	2.3	2.3	2.3	2.4	2.7	2.6	2.7	2.8
Overall balance on a cash basis	-4.6	-2.8	-1.4	-1.0	-2.1	-3.9	-3.5	-2.5	-1.8	-1.8	-1.8
Domestic financing	2.8	1.7	0.2	-1.0	1.6	-0.4	1.5	0.4	1.2	0.9	1.5
External financing	1.8	1.1	1.3	1.9	0.5	3.4	1.0	1.2	0.6	0.9	0.3
Other financing	…	…	…	0.0	0.0	0.9	0.9	0.9	0.0	0.0	0.0
Public and publicly-guaranteed debt 1/	39.7	42.0	41.2	40.8	43.1	48.2	50.6	51.6	51.3	51.1	50.9
External sector											
Exports of goods and services	23.9	27.0	27.5	28.4	28.5	30.4	30.1	29.6	28.9	28.1	27.6
Imports of goods and services	49.0	48.5	48.3	48.2	47.0	43.7	44.0	43.3	42.3	41.2	40.2
Current account (in percent of GDP)	-13.6	-10.4	-10.0	-7.6	-7.3	-4.9	-5.8	-6.0	-5.9	-5.8	-5.6
Current account (in millions of U.S. dollars)	-1,261	-1,059	-1,058	-845	-849	-520	-616	-664	-688	-710	-724
Capital and financial account (in millions of U.S. dollars)	1,117	1,007	848	1,789	260	649	574	743	784	845	830
Of which: direct foreign investment	521	437	481	508	388	334	438	448	462	478	495
public sector disbursements	193	180	255	914	257	740	271	323	284	343	785
Change in gross int. reserves (millions of U.S. dollars) 2/	138	-4	70	-454	764	-222	67	-148	-30	-57	-21
Arrears and debt relief (in millions of U.S. dollars)	0	0	0	0	0	0	0	0	0	0	0
Financing gap (in millions of U.S. dollars)	0	0	0	0	0	117	146	123	0	0	0
Of which: IMF	0	0	0	0	0	17	46	23	…	…	…
Other	0	0	0	0	0	100	100	100	…	…	…
Gross international reserves in months of imports	4.6	4.4	4.0	4.9	3.9	4.4	4.5	4.7	4.6	4.6	4.7
Memorandum items:											
Debt-creating fiscal balance 3/	-5.9	-2.2	-2.3	-1.1	-2.8	-5.0	-4.4	-3.3	-2.6	-2.6	-2.6

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ Includes prospective EADB financing ($100 million in 2015, 2016, and 2017).

2/ A negative figure indicates an increase.

3/ Sum of overall balance (above-the-line) and external net lending.

Table 8. Armenia: Indicators of Capacity to Repay the Fund, 2011–20

	2011	2012	2013	2014	Projections 2015	2016	2017	2018	2019	2020
Fund obligations based on existing credit (in millions of SDRs)										
Principal	14.4	101.0	180.2	98.1	16.4	25.3	36.9	45.2	52.8	51.4
Charges and interest	8.3	7.6	5.5	2.4	2.0	1.6	1.4	1.2	1.2	0.8
Total obligations based on existing and prospective										
In millions of SDRs	22.7	108.6	185.7	100.5	18.7	27.3	39.0	47.0	54.6	54.6
In millions of U.S. dollars	35.9	166.3	282.3	146.7	27.2	39.8	57.2	69.4	81.3	81.9
In percent of gross international reserves	1.9	9.2	12.5	9.9	1.6	2.2	3.0	3.5	4.0	4.0
In percent of exports of goods and services	1.3	5.7	8.9	4.4	0.8	1.2	1.7	2.1	2.4	2.3
In percent of debt service 2/	35.3	69.3	32.0	52.5	14.6	18.6	23.0	24.8	25.8	9.8
In percent of GDP	0.4	1.6	2.5	1.3	0.3	0.4	0.5	0.6	0.7	0.6
In percent of quota	24.7	118.0	201.9	109.2	20.4	29.6	42.3	51.1	59.4	59.4
Outstanding Fund credit based on existing credit 2/										
In millions of SDRs	539.0	505.0	379.7	305.1	288.7	263.4	226.6	181.4	128.6	77.2
In millions of U.S. dollars	850.9	773.5	577.1	445.4	419.4	384.3	332.4	267.9	191.4	115.8
In percent of gross international reserves	45.5	43.0	25.6	29.9	24.5	21.6	17.3	13.7	9.5	5.7
In percent of exports of goods and services	31.0	26.5	18.3	13.4	13.0	12.0	10.1	8.0	5.5	3.2
In percent of debt service 2/	837.6	322.2	65.5	159.3	224.9	180.0	133.5	95.8	60.7	13.8
In percent of GDP	8.4	7.3	5.2	3.8	4.0	3.6	3.0	2.3	1.6	0.9
In percent of quota	585.8	548.9	412.8	331.6	313.8	286.3	246.3	197.2	139.7	83.9
Net use of Fund credit based on existing and prospective credit (in millions of SDRs)	58.0	-34.0	-125.2	-74.6	-4.7	6.0	-21.2	-45.2	-52.8	-54.6
Disbursements	72.4	67.0	55.0	23.5	11.7	31.3	15.7	0.0	0.0	0.0
Repayments and repurchases	14.4	101.0	180.2	98.1	16.4	25.3	36.9	45.2	52.8	54.6
Memorandum items:										
Nominal GDP (in millions of U.S. dollars)	10,142.1	10,619.3	11,121.5	11,644.4	10,606.9	10,672.2	11,074.2	11,630.1	12,273.2	12,939.0
Exports of goods and services (millions of U.S. dollars)	2,742.2	2,917.9	3,155.9	3,318.9	3,226.2	3,215.4	3,278.9	3,359.1	3,450.5	3,570.7
Gross international reserves (millions of U.S. dollars)	1,869.5	1,799.4	2,253.0	1,489.4	1,711.9	1,778.9	1,926.6	1,956.3	2,013.0	2,038.8
Debt service (in millions of U.S. dollars) 2/	101.6	240.1	881.7	279.6	186.5	213.5	249.0	279.5	315.5	839.1
Quota (in millions of SDRs)	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0	92.0

Source: Fund staff estimates and projections.

1/ Indicators cover both GRA and ECF credit.

2/ Total debt service includes IMF obligations.

Table 9. Armenia: External Financing Requirements and Sources, 2014–17
(In millions of U.S. dollars, unless otherwise indicated)

	2014	2015	2016	2017
	Est.		Proj.	
Gross Financing Requirements	1,014	1,608	1,383	1,572
External current account deficit (excl. transfers)	1,593	1,101	1,208	1,285
Debt amortization and Fund repurchases	184	284	107	139
Gross international reserve accumulation	-764	222	67	148
Available financing	933	1,491	1,237	1,449
Capital Account and Current Transfers	933	1,491	1,237	1,449
of which: Capital transfers (net)	70	66	77	66
Foreign Direct Investment	388	334	438	448
Public Borrowing	216	479	201	238
Private transfers	641	461	471	485
Commercial banks net flows	-39	-167	-59	20
Financing gap	80	117	146	123
Exceptional Financing	80	117	146	123
Of which: IMF EFF program	0	17	46	23
Other 1/	0	100	100	100
Memorandum item:				
Current Account deficit, percent of GDP	-7.3	-4.9	-5.8	-6.0
Fiscal balance, percent of GDP	-2.1	-3.9	-3.5	-2.5
Net International Reserves	1,215	1,415	1,430	1,560
Gross Reserves	1,489	1,712	1,779	1,927
In months of prospective imports	3.9	4.4	4.5	4.7

Sources: Armenian authorities; and Fund staff estimates and projections.

1/ Prospective financing from EFSD.

Table 10. Armenia: Fund Disbursements and Timing of Review Under the 38-Month Arrangement Under the Extended Fund Facility (revised, proposed)

Date of Availability	Conditions	Amount (millions of SDRs)	Percent of Quota
		EFF	EFF
March 7, 2014	Board approval of the arrangement	11.74	12.76
September 30, 2014	Observance of end-June 2014 performance criteria and continuous performance criteria, and completion of first review	11.74	12.76
March 30, 2015	Observance of end-December 2014 performance criteria and continuous performance criteria, and completion of second review. 1/	11.74	12.76
March 30, 2016	Observance of end-December 2015 performance criteria and continuous performance criteria, and completion of third review	15.65	17.01
September 30, 2016	Observance of end-June 2016 performance criteria and continuous performance criteria, and completion of fourth review	15.65	17.01
March 30, 2017	Observance of end-December 2016 performance criteria and continuous performance criteria, and completion of fifth review	15.69	17.05
	Total	82.21	89.36

Source: Fund staff estimates and projections.

1/ However, this review is based on end-June 2015 PCs, which have become the controlling PCs.
All subsequent purchases are proposed to be rephased.

Appendix I. Letter of Intent

Christine Lagarde
Managing Director
International Monetary Fund
Washington, D.C. 20431
United States of America

Yerevan, October 22, 2015

Dear Madam Lagarde:

1. **In late 2014 and 2015, Armenia's economic performance has been affected by weaker external conditions**, including the slowdown in Russia, ruble depreciation, and lower copper prices. Remittances have declined sharply, and exports also have been lower. Pressures emerged in the foreign exchange (FX) market, leading to depreciation of the dram in late 2014 and tighter monetary policy. Although inflation has remained below the upper boundary of the confidence band (4 ± 1.5 percent), it rose at end 2014 and in the first half of 2015, while bank credit slowed, nonperforming loans (NPLs) increased, and bank profitability worsened. Favorable weather and strong agricultural output, along with the opening of a new copper mine, have boosted growth in 2015, but activity in other sectors remains subdued. The external current account deficit has adjusted significantly in 2015, as dram deprecation and lower remittances and hydrocarbon prices and volumes have contributed to a sharp decline of imports. Meanwhile, dram depreciation vis-à-vis the U.S. dollar has expanded exports to non-traditional and new markets. There has been strong export growth in agriculture and mining and to countries outside of the Eurasian Economic Union, for example, in the Middle East.

2. **The outlook is challenging**. Activity is expected to pick up only moderately in 2015–16. Fiscal revenues are lower than budget projections—increasing the deficit and financing needs—and public debt is expected to rise above 50 percent of GDP. The outlook is subject to a high degree of uncertainty, as intensification of regional geopolitical tensions or slowing global growth could cause negative spillovers. By contrast, if oil prices and activity in Russia pick up, conditions would improve. We will hold a referendum on constitutional changes in December that would change the governance structure of Armenia from a mixed presidential-parliamentary system to a parliamentary system.

3. **Performance under the IMF-supported program has come under pressure.** Most December 2014 and June 2015 performance criteria (PCs) were missed. These were agreed in September 2014, before the worsening of external conditions. December and June PCs on net international reserves (NIR) and net domestic assets (NDA) of the Central Bank (CBA) were missed

due to FX sales and liquidity support to banks. The December and June fiscal deficit targets were missed due to budgetary lending that exceeded programmed amounts.

4. **We have made progress in our structural reform agenda**. A fiscal risk assessment division at the MOF was established (December 2014 structural benchmark, SB), a taxpayer compliance program was prepared (December 2014 SB), and an action plan to enhance tax compliance in selected sectors was completed (December 2014 SB). In addition, we completed a policy paper on CBA liquidity and reserve requirements (March 2015 SB), and prepared legislation to improve the bankruptcy process (June 2015 SB). We prepared a policy note on strengthening taxation of high-wealth individuals and made progress in the financial and strategic assessment of CBA-owned companies related to financial development and architecture (June SBs), although further work is needed in these areas. Other structural reforms are progressing.

The Program for 2015–16

5. **Our policy objectives remain focused on sustaining macroeconomic stability and fostering strong, inclusive growth.** Our immediate focus is to continue to stabilize conditions in the financial and FX markets and to implement countercyclical fiscal policies to support growth. Structural reforms aim at an improved business environment and enhanced and more diversified regional and global economic integration. We consider that the adjustment of the external current account deficit that has taken place in 2015 is sustainable. Energy imports could pickup with cold winter weather, and while higher growth will lead to additional imports, this should be balanced by higher remittances and capital and investment inflows.

6. **As public debt has increased in recent years, strengthening debt sustainability is a key priority**. Accordingly, we will consolidate the fiscal position from 2016 and pursue concessional financing where possible. Given the uncertain environment, we issued a second Eurobond in March to provide financing, increase buffers, and repay a portion of 2013 Eurobond, improving our debt profile. Further financing is needed to cover remaining gaps and maintain buffers, and we have approached the Eurasian Fund for Stability and Development for budget support of $300 million for 2015–17. We will continue to consult with the Fund staff before taking on significant new liabilities.

Fiscal Policy

7. **We are taking steps to bring fiscal performance in line with program objectives.** While the 2014 headline deficit was below the budgeted amount, the end-2014 fiscal deficit PC was missed, due to higher budgetary lending.[1] A large loan ($65 million or 0.6 percent of GDP) not originally planned in the budget was made to support development of a new copper mine that will

[1] Budget lending, which is recorded as a financing item, is *excluded* from the calculation of the program fiscal balance, effectively treating lending as expenditure when loans are made and as a revenue when loans are repaid (see the Technical Memorandum of Understanding).

boost exports and employment in a depressed region. Similarly, the June 2015 fiscal deficit PC was missed due to unbudgeted lending, focused on support to the Nagorno-Karabakh administration to deal with the difficult economic environment, on support to SMEs in agriculture via an interest rate subsidy on local bank loans, and on a loan to support development of a major real estate project, while addressing property and housing claims. These loans are expected to be funded partly by sale of a large sports and entertainment complex in Yerevan. Going forward, we will limit direct government loans, focusing instead on facilitating private investment and addressing legal and social issues related to projects. We will work to bring in private and IFI investments, thereby retaining government financial liquidity and buffers and mitigating risks to public finances. In view of the missed fiscal deficit PC, a new PC will be established on domestic budget lending as a corrective action to focus more attention on our lending programs. We consider budgetary lending to be an effective way to boost activity and jobs, while sharing risks with local banks and investors and generating future repayments. To strengthen effectiveness and risk minimization, we will publish regular, consolidated statements across all domestic lending programs, including outstanding stocks of budget loans (new December 2015 SB). We will also arrange for a review of our lending operations by the Fiscal Risk Assessment Division (FRAD) of the MOF to identify risks and management improvements (new June 2016 SB). In light of the larger-than-expected lending that took place in 2014 and the first half of 2015, we will also reduce the IT limit on government guarantees.

8. **Meeting the 2015 fiscal targets has proved challenging, and budget implementation has aimed to support activity.** The 2015 budget was based on growth of 4.1 percent, and we have experienced revenue shortfalls due to both lower activity and policy changes. These have included elimination of the minimum profits tax, reduction of the turnover tax rate, extension of the payment date for VAT collections for imports from Eurasian Economic Union (EEU) countries, and a shift to reporting VAT on an accrual basis. Transfers from the EEU customs pool have been smaller than expected, due to a contraction of EEU imports this year. We now envisage a headline deficit of around 4 percent of GDP this year, compared with 2.3 percent in the budget, reflecting lower revenues and additional capital spending, including on roads, school modernization, and defense procurement. Additional spending items have also arisen, including related to higher electricity tariffs and a referendum on constitutional reform. Our current tax revenue estimates (including VAT refunds and individual pension contributions) suggest collections this year of approximately AMD 1,070 billion, about AMD 70 billion below the budget. Improved economic developments in the remainder of the year and strengthened tax administration efforts in areas where policy changes have taken place could possibly yield additional revenues of AMD 10–15 billion.

9. **We will initiate consolidation in 2016 to reduce the deficit over the medium term to a level consistent with debt sustainability.** We will bring the headline deficit down to 3.5 percent of GDP next year, with further consolidation in 2017–18 to reduce the deficit below the debt-stabilizing level and put debt on a declining path. A combination of revenue measures and expenditure restraint will underpin the adjustment. Notwithstanding new tax measures, revenue projections for 2016 are cautious, reflecting continuing macroeconomic difficulties, depressed profitability in key sectors (banking, mining), and continuing uncertainty from policy changes (turnover tax, VAT). For example, during 2016–18, we will increase the VAT threshold, while increasing the turnover tax rate

from 3.5 to 5 percent. Small taxpayers will have the possibility to apply for a reduced turnover tax rate of 1 percent if they present invoices on purchases. This measure aims to enhance reporting and VAT collections from wholesalers, but it may lead to revenue losses. We will strengthen administration by extending the coverage of goods required to carry stamps as evidence of tax payment, and we stand ready to take additional tax policy and/or revenue administration measures to offset revenue shortfalls.

10. In tax policy, the focus will be on adjusting excise tax rates and broadening the tax base by eliminating exemptions and gaps. Excise revenues have eroded in recent years, as adjustment of specific rates has not kept pace with growth and inflation. The case for increasing excise rates is supported by their relatively low impact on growth, addressing negative externalities and health effects, and lower global energy prices. The National Assembly is expected to approve in October an increase of excise tax rates on gasoline and diesel fuel, vodka and cigarettes, and a new excise tax on compressed natural gas (CNG)—these measures (prior action) are expected to yield at least 0.1 percent of GDP in 2016. We will also seek parliamentary approval of further excise tax rate increases from 2017 to bring them gradually in line with rates in other EEU member countries.

11. We have drafted a new tax code that aims to address long-standing tax policy and revenue administration issues. The code envisages a reduction of compliance costs through well-defined tax principles and rights and obligations of taxpayers and the tax administration, in line with best international practices. It also envisages a redesign of the tax system to achieve greater simplicity and fairness, better promote growth, and reduce inequality, by revisiting the level and structure of income taxes, eliminating exemptions, and strengthening coverage of high-wealth individuals and large companies. This, in turn, should lead to higher tax revenues to support consolidation starting from 2017 with additional contributions thereafter and also permitting higher growth-enhancing capital and social spending. The new tax code envisages a shift to greater taxation of consumption, a reduction of tax expenditures by reducing non-targeted VAT and income tax exemptions and incentives. More specifically, the tax code proposes to eliminate income tax and VAT exemptions in health and education, commercial agriculture, and other sectors (e.g., some financial sector services), while bringing diesel fuel under the VAT regime. Depending on revenue gains, income tax rates expect to be decreased in the future. The transition will be phased (e.g., through initially lower rates) to ease the impact of these policy changes. The draft tax code was issued for public comment in October, and it will also benefit from a review by the IMF's Fiscal Affairs and Legal Departments on every major tax. A final proposed code will be submitted to the National Assembly by early 2016 (new March 2016 SB).

12. Strengthening tax and customs administration remains a priority. The degree of compliance affects both collections and the efficiency and fairness of the tax system. Our 2015 tax compliance program (December 2014 SB) combines enhanced risk-based audit with taxpayer training and support and simplification of laws and procedures. We expect to fully transition to electronic documentation from 2016. A particular focus area is on underreporting of turnover, including by both SMEs and large taxpayers. To address this, we have increased by 10 percent the number of taxpayers covered by the large taxpayers unit (LTU) and also increased LTU staff by 10 percent. Accession to the EEU has presented challenges for customs administration, for example, with respect to customs procedures and documentation at border crossings, customs offices, and warehouses. Changes related to EEU accession resulted in delays in compiling trade data, and we will ensure that export and import data are provided on a timely basis to the National Statistical Service. To improve efficiency of customs administration, we will undertake a thorough review of responsibilities and eliminate overlaps and duplication in line with IMF FAD advice.

13. On expenditures, we are improving investment budget execution, while continuing to strengthen social spending. In line with our analysis of capital budget implementation shortcomings (April 2015 SB), project implementation units (PIUs) are now required to submit to the Prime Minister's office monthly progress reports, with expected outcomes and implementation risks. We are moving ahead on several important major capital projects, including the North-South and M6 highways, roads around Yerevan, and school modernization and rehabilitation. Social spending was increased by nearly 11 percent in the 2015 budget, compared with the 2014 outturn. The difficult budget situation will reflect on current spending in the coming years, but we aim to at least maintain the level of expenditure under our social programs, and where possible, increase coverage. A new Social Assistance Law became effective in 2015, along with secondary legislation. We will consider the possibility of supporting energy consumption by the poor by means of increasing monthly direct payments and by bringing directly into the budget a "lifeline" gas subsidy that has been financed by state-owned power companies.

14. We aim to ensure that fiscal risks are better identified, analyzed, disclosed, and managed. We have established a fiscal risk assessment division (FRAD) in the MOF to monitor risks from regulated utilities, enterprises with state participation, concessions, and PPPs (December 2014 SB). We are working to build the division's capacity, and we have received IMF TA to develop an operating manual and will ensure that the legal framework and data sharing mechanisms are in place for the FRAD to fulfill its mandate.

15. Implementation of our flagship pension reform is continuing. About 132 thousand workers have enrolled in the new pension system since the revised pension law was approved in 2014, including 60 thousand from the private sector. To support implementation of the reform, we have issued an action plan with technical and policy measures, including appointing a reform 'champion'—a Deputy Finance Minister—to lead interagency efforts and fixing the IT system to ensure swift accounting and reporting of individual contributions. We will also strengthen our outreach campaign with TV commercials, printed materials, an Internet portal and information hotlines. The 2016 budget includes funding for the Pension System Awareness Center and the outreach campaign.

Monetary and Exchange Policy

16. Monetary and ER policy actions taken in 2014–15 aimed to mitigate inflationary and FX pressures within the inflation-targeting framework. Heightened uncertainty in late 2014 and risks to inflation and financial stability called for decisive actions. These covered both ER actions (FX sales, communications with the public and the market) and monetary policy actions (tightening dram liquidity through higher reserve requirements and Lombard interest rates). Renewed pressures from January, compounded by seasonal FX demand for gas imports, led us to provide additional FX to the market. While we were mindful that our Q1 2015 intervention exceeded the FX sales envisaged in our December understanding with the Fund staff, we considered that greater intervention was needed to prevent disorderly adjustment. The external position has improved and the FX market has largely stabilized, but remains fragile, as inflation expectations are not properly anchored. This was shown in August, when the depreciation of the Kazakh tenge and market volatility in China led to renewed pressures and temporary CBA intervention.

17. Our ER policy objectives are to allow for flexibility while enhancing reserve buffers when conditions permit. We have reduced FX sales since February, with the exception of August pressures, and we intend to strictly limit further net FX sales prior to IMF Executive Board consideration of the Second Review (prior action), for the rest of 2015, and in 2016. We also intend to enhance FX buffers when market conditions permit. This return to a more flexible ER regime constitutes a corrective action for the missed December 2014 and June 2015 PCs. With the adjustment of the external current account deficit in 2015, we consider that the dram is not overvalued. Going forward, we will be prepared to mitigate excessive, transitory ER pressures, while allowing the dram to respond to structural changes in both directions (appreciation and depreciation). If unexpected strong and sustained pressures emerge, we will allow the dram to move to a new equilibrium level, with limited intervention to smooth excessive fluctuations. As uncertainties remain high, the CBA will continue active communications with the financial sector, the business community and the public, both in terms of explaining developments (e.g., via the inflation report and press releases) and assessing forward-looking prospects and risks (press conferences and other mass-market channels).

18. Maintaining price stability remains our guiding principle, and we continue to strive for dedollarization. Policy rate adjustments will continue to aim to keep inflation at the target of 4 percent. With FX market conditions stabilizing, we have eased the domestic liquidity actions taken in late 2014, while working to deepen the interbank money market. We have restored the interest rate corridor, reducing the Lombard rate sharply from January and increasing the policy rate. Given a perception that there are still inflationary pressures, we have maintained a tightening stance, and will reassess the situation continuously. Anchoring inflation expectations remains on the agenda of monetary policy; this may call for disinflation policy, if shocks persist. We have reduced reserve requirements for FX deposits from 24 to 20 percent (held in AMD), although these remain well above pre-December 2014 levels. We have introduced lower reserve requirements for more stable sources of funding. Further adjustments to reserve requirements, including the currency of denomination, will be implemented as conditions permit and informed by our recent policy paper on liquidity and reserve requirement regulations (March 2015 SB). We have finalized rules for an interbank money market for one- and seven-day collateralized instruments. This new market may develop slowly, as collateral remains a constraint, along with commercial bank risk perceptions. However, as the market develops, it will play a key role in our monetary infrastructure. We are also investigating mechanisms for bank ratings to help clarify risk. With further normalization of conditions, we expect to transition to inflation targeting-based conditionality under the Fund-supported program.

19. We continue efforts to strengthen CBA independence and operations. As part of the constitutional referendum, the National Assembly has approved legal changes that would strengthen the CBA's mandate to financial stability and the process for appointment and confirmation of CBA board members. The CBA has also revised its board charter to clarify the roles and responsibilities of board members. Further, the CBA has enhanced the presentation of its investments in firms in financial sector development and infrastructure (e.g., credit card processing, mortgage finance, cash collection). In its most recent annual report, the CBA presented financial statements for these firms, along with a consolidated financial position (June 2015 SB). Further work is underway to present in next year's annual report the objectives for these investments, risks and risk-mitigation efforts, and the CBA's development or divestment strategy. In the context of strengthening its independence and operations, the CBA will divest ownership of PanArmenian Bank, a development bank established in 2009 and fully owned by CBA, which is responsible for supervising its activities. The CBA will prepare a plan by December 2015 to sell PanArmenian Bank to a private investor, transfer its ownership to the government, or to close it and sell its loan portfolio. Finally, we have worked with the National Statistical Service to provide the CBA with access to company-level data for non-financial firms needed to analyze the BOP statistics and developments.

Financial Sector Stability and Development

20. The current environment is placing strains on local banks, and we are implementing measures to strengthen the sector's resilience and efficiency. We raised bank minimum capital requirements six fold to AMD 30 billion, effective January 1, 2017, to increase capital buffers and efficiency and enhance banking services via greater economies of scale. Some banks have already increased capital, while others are raising funding or considering mergers. Banks are expected to achieve the new requirement on their own, with no CBA or government involvement. The CBA and the government stand ready to assist the banks in making contacts with potential investors, especially IFIs (EBRD, IFC) to facilitate transactions, but will not provide financial support (except in cases when the CBA may provide loans to banks under lender-of-last-resort or systemic provisions of Article 38 the CBA Law). We will provide the Fund staff with the necessary information for continuous assessment of banking conditions, including capital plans of local banks.

21. We are also strengthening safety nets and contingency planning. We have further strengthened safety nets by (i) formalizing an agreement for the DGF to become eligible to engage in liquidity repo transactions with the CBA; (ii) issuing regulations to preclude the DGF from engaging in transactions with banks outside of its core mandate; (iii) issuing a joint CBA-MOF decision stating that the CBA and MOF will refrain from appointing or electing active bankers to the DGF board; and (iv) further developing crisis management skills through periodic crisis simulation exercises, along the lines of the exercise held last year with help of the World Bank. We will also work with the Association of Banks to ensure that the Association's representative on the DGF board is not an active banker. In addition, we are planning to raise the maximum amount of deposits insured by the Deposit Guarantee Fund (DGF) and reduce the deposit insurance payout period. Furthermore the CBA continues to strengthen its contingency planning and has required banks to prepare contingency plans. We are taking steps to improve and enhance our stress testing framework, including by continuously assessing the adequacy of key stress testing parameters and developing new scenarios based on alternative default probabilities and macroeconomic assumptions. When conditions warrant, the CBA will take early, remedial action—before legal triggers to appoint a provisional administrators are activated and within the scope of powers under the Law on Banks and Banking—to mitigate risks of financial deterioration or asset stripping of a bank and to protect depositor and creditor interests. If conditions weaken further (e.g., NPLs, profitability), the CBA will intensify its asset quality review for the most-affected banks.

22. Progress in other areas will strengthen buffers and ease constraints on intermediation. In line with Basel III guidance for transitioning to a risk-based supervision framework, the methodology on domestic systemically important banking institutions has been adopted, with additional supervisory resources being devoted to these institutions. Basel III requirements for new issuances of subordinated debt as regulatory capital, and more generally, for minimum capital requirements, have been in place since the beginning of 2015, and banks are gradually transitioning to them. We continue to support financial sector development by removing obstacles hindering the registration and execution of collateral; we submitted a draft law in this area to the National Assembly (September 2015 SB).

Structural Reforms

23. Objectives. The external shock that we have experienced since late 2014 has not only affected the short-term outlook, but also potential growth. Given lower medium-term growth forecasts for Russia and prospects for an extended period of lower remittances and other financial inflows, our potential growth is now estimated at 3.5 percent versus 4.5–5 percent previously. Therefore, along with stepped up capital spending, the comprehensive reforms set out in our Armenian Development Strategy to mitigate risks and improve institutions, the business climate, competition, openness, connectivity, and diversification, are even more pressing.

24. Sound management of the energy sector is critical to mitigating risks and sustaining strong growth. Local energy companies have experienced financial strains, due to dram depreciation, slowing growth, lags in tariff adjustment, short-term borrowing, and non-core activities. Our actions have focused on mitigating short-term impacts, including through tariff adjustments and a lower gas price agreed with Russia and Gazprom. More specifically:

- A significant concern has been the weaker financial position of the privately-owned electricity distributor, ENA, including the accumulation of short-term debt to local banks and state generation and transmission companies. This was caused, in part, by higher-than-planned generation costs (more thermal, less hydro and nuclear) in 2014. The Public Service Regulatory Commission approved higher electricity tariffs in June 2015 to recover past losses, but this decision was met by public protests and questions. Accordingly, we suspended the application of the higher tariffs for households and SMEs, pending completion of external audits of the ENA and of the regulatory process. The examination of the PSRC tariff setting has been just completed by an international audit firm, which upheld the Commission's decision. Given the financial hardships of the year, we decided to continue financing tariff differential temporarily for one year from non-budget resources outside of the public sector; this financial support does not cover big business or wealthy individuals and will be strictly limited to a maximum of $12 million.

- More broadly, we are considering options for energy sector operations, finances, tariff policies, and investment, guided by the two audits and cooperation with the World Bank on an energy sector financial recovery plan. ENA is being sold to a new investor who has committed not to incur new debts and within 5 years to bring the management of the company to international quality standards. The financial recovery plan will involve: new loans from IFIs to restructure expensive short-term debt; agreement on a repayment plan for accumulated debt to energy suppliers; a strict prohibition on expenses, borrowing and lending by energy companies outside of their core mandate; tariff adjustments, where needed; and a new tariff mechanism to more quickly transfer the risk of deviations from the planned energy-generation mix to consumers, in line with best international practices (new March 2016 SB). We have reduced to a minimum support from the state to two financially-ailing chemical companies, Nairit and Vanadzor, with Nairit's wage arrears cleared in August. Now, Nairit is in bankruptcy proceedings. Throughout this process, the public sector will not absorb losses or liabilities or make payments on behalf of utility companies or other companies (continuous PC), including in the context of a possible sale of ENA.

- We need to replace the aging Armenia Nuclear Power Plant (ANPP) over the next decade in a way consistent with long-term financial sustainability. ANPP provides 25 percent of our electricity, and we have secured $300 million in concessional financing from Russia to extend its life until 2026. We are considering options to replace ANPP with a new nuclear reactor or gas-fired plants. As this could potentially cost 50 percent of GDP or more, we will work with the World Bank and other partners to consider options in a least cost framework, compatible with debt sustainability and involving other partners and the private sector to reduce risks. Finally, we recognize that continued modernization and upgrading of aging gas and electricity transmission and distribution networks will require significant investment going forward. This will need to be reflected in tariffs, while companies make significant efforts to improve efficiency and ease cost pressures.

25. Other structural reforms areas:

- ***Business climate.*** Efforts to improve the business climate have been positive. Armenia ranks 45th of 189 countries in the World Bank's 2015 Doing Business rankings—the highest among EEU members. Our 2015 Doing Business action plan aims at further gains in areas where we lag behind, such as electricity connections, trading across borders, enforcing contracts, and construction permits. The government has approved a Small and Medium Enterprise (SME) Action Plan to boost competitiveness and create jobs in this critical sector. With assistance from the AsDB and JICA, the plan includes measures to improve training, provide support for startups, set up a loan guarantee program for SMEs, link local SMEs to global supply chains, and foster women entrepreneurship and youth mobilization.

- ***Regulatory guillotine.*** We continue streamlining efforts through the regulatory guillotine program. In 2012, our goal was to streamline regulations to cut the cost of doing business by 50 percent. Since then, measures have been implemented to reduce costs by roughly 8 percent. Unfortunately, there are administrative and legislative backlogs for about 600 proposals to cut costs further. To expedite the process and maximize cost reduction, in March 2015, the cabinet approved a decree authorizing 41 measures in tax and customs administration, patents, and government processes to yield further cost reductions of about 30 percent. We have approved a decree establishing the practice of regulatory impact assessment for new regulations to better identify costs and benefits of new regulations and help monitor effectiveness once they are in place.

- ***Institutional administration.*** Improving tax compliance through stronger documentary evidence of transactions is a key element in raising revenues and ensuring that the tax burden is shared fairly. We approved an action plan to improve tools for recording value added by overhauling accounting, reporting, and IT systems (December 2014 SB). Implementation of the plan is helping to improve collection of tax base information in energy, health, construction, private education, transportation, and agriculture. This, in turn, will help assess taxes and fees and ensure timely payment to the budget.

- ***Bankruptcy reform.*** Shortcomings in bankruptcy and court processes result in significant delays. Together with other state agencies and stakeholders, the Ministry of Justice has reviewed lessons from the bankruptcy outlining undertaken last year and prepared draft legislation for cabinet consideration. We are also developing programs for judicial specialization in bankruptcy, training for bankruptcy judges, and enhanced qualification criteria for bankruptcy administrators.

- ***Civil aviation***. Institutional improvements in civil aviation and the "Open Skies" policy have resulted in enhanced connectivity, lower costs, and a boost in tourism. The National Assembly has approved amendments to the Civil Aviation Law that put in place the separation of functions and responsibilities between the Ministry of Economy and the Directorate General for Civil Aviation. Growth prospects will improve further once we finish negotiations of 15 bilateral aviation agreements, including the Common Aviation Area Agreement with the EU, which will encourage entry of low-cost carriers.

Conclusion

26. We request that the IMF Executive Board completes the Second Review of the EFF-supported program. We also request waivers of nonobservance in respect of missed PCs on the basis of the temporary nature of the breaches and corrective actions taken. We have learned that the Fund staff considers that a longstanding agreement between the CBA and the MOF to use a budgetary exchange rate (ER) for government FX transactions gives rise to a multiple currency practice (MCP), subject to IMF jurisdiction. As the arrangement was introduced nearly a decade ago, we understand that it has no program implications. However, an amendment to the ER framework in

March constitutes nonobservance of the program PC, and we therefore request a waiver for this non-observed PC, given that the breach was temporary and limited to a single transaction, which was carried out at a rate that was within 2 percent of the prevailing market ER. We request that an amount equivalent to SDR 11.74 million be made available upon completion of the review. In light of the delay in considering the Second Review, we request that the remaining purchases under the arrangement be rephased, so that there will be two remaining purchases each in the equivalent of SDR 15.65 million, subject to two reviews and 15.69 million subject to the last review. The third, fourth and final reviews under this arrangement are expected to be completed on or after March 30, 2016, September 30, 2016 and March 30, 2017, respectively. The arrangement will expire as planned in May 2017.

27. We will maintain a close dialogue with the Fund and stand ready to take additional measures, as needed, to ensure achievement of our objectives under the Fund–supported program. We will continue to consult in advance with the Fund staff on adoption of measures or revision of the policies contained in the MEFP, in accordance with Fund policies on such consultations. We will provide the Fund with information it requests for monitoring program implementation. The program's proposed PCs, ITs, and SBs are set out in Tables 1 and 2 and described in the attached Technical Memorandum of Understanding (TMU).

28. We authorize the IMF to publish this Letter of Intent and its attachments, as well as the accompanying staff report.

Very truly yours,

/s/
Hovik Abrahamyan
Prime Minister
Republic of Armenia

/s/
Gagik Khachatryan
Minister of Finance
Republic of Armenia

/s/
Artur Javadyan
Chairman of the Central Bank
Republic of Armenia

Table 1. Armenia. Quantitative Targets for 2013-16[1]

(In billions of drams, at program exchange rates, unless otherwise indicated)

	2013	2014			2015												2016			
	Dec.	Dec.			Mar. 2/			Jun.			Sep.			Dec.			Mar.	Jun.	Sep.	Dec.
	Act.	EBS 14/18	Adj. Prog.	Act.	EBS 14/148	Adj Prog.	Proj.	EBS 14/148	Adj. Prog.	Proj.	EBS 14/148 2/	Adj. Prog. 2/	Proj.	EBS 14/148 2/	Adj. Prog. 2/	Prog.	Prog. 2/	Prog.	Prog. 2/	Prog. 2
Performance Criteria																				
Net official international reserves (stock, floor, in millions of U.S. dollars)	1,068	1,026	999	796	857	1,190	902	845	1,170	913	833	1,204	832	879	1,347	992	954	955	1,079	1,050
Net domestic assets of the CBA (stock, ceiling) 3/	231	318	445	478	301	299	370	337	306	377	366	346	434	419	356	444	387	426	400	464
Program fiscal balance (flow, floor) 4/	-40	-139	-122	-161	-36	-31	-34	-71	-76	-94	-107	-115	-189	-143	-159	-264	-58	-112	-165	-218
Budget domestic lending (cumulative flow, ceiling)																31	15	15	15	15
External public debt arrears (stock, ceiling, continuous criterion)	0	0	0	0	0	0	0	0	0	0	0		0	0		0	0	0	0	0
Absorption of losses or liabilities and making of payments on behalf of utilities and other companies (flow, ceiling, continuous criterion)		0	0	0	0	0	0	0	0	0	0		0	0		0	0	0	0	0
Indicative Targets																				
Inflation (mid-point, percent) 5/	5.6	4.0	4.0	4.6	3.1	3.1	5.7	3.3	3.3	5.5	3.4		3.2	3.6		3.4	3.0	3.3	3.5	4.0
Avg. concessionality of newly contracted external debt (flow, floor, in percent) 6/	30	30	30	39							30			30		30				30
New government guaranteed external debt (stock, ceiling, in millions of U.S. dollars) 7/		100	100	0	100	100	0	100	100	0	100		0	100		50	50	50	50	50
Social spending of the government (flow, floor) 8/	34	48	48	47	12	12	12	26	26	26	40		40	54		54	13	27	42	57
Memorandum items:																				
Budget support grants	48	55		55	55		55	55		55	55		59	62		66	66	66	66	72
o.w. EU MFA grant	19	19		19	19		19	19		19	19		19	19		19	19	19	19	19
Budget support loans	144	191		186	168		304	168		304	168		304	201		378	398	398	455	455
o.w. non-IMF loans	105	153		148	130		266	130		266	130		266	162		339	360	360	417	417
Project financing	83	83		67	11		7	23		27	34		48	46		71	19	37	56	74
KFW and IBRD loan disbursements	27	40		39	47		48	51		49	56		69	60		71	76	79	87	89
Reserve money	888	828		887	825		792	782		818	796		883	1001		930	866	904	909	975

Sources: Armenian authorities; and Fund staff estimates.

1/ All items as defined in the TMU.
2/ Indicative target.
3/ NDA ceiling will be considered met if the outcome is within AMD 15 billion of the target.
4/Below-the-line overall balance excluding net lending.
5/ End of period, year-on-year headline inflation. Mid-point within a +/- 1.5 range.
6/ Assessed on a calendar year basis.
7/ Includes both concessional and non-concessional debt.
8/ Defined as 100 percent of the budgeted amount of the family benefit program and lump-sum financial aid.

Table 2. Armenia. Prior Actions for the Completion of the Second Review[1/]

Measure	Status
1. CBA net sales in the foreign exchange market not to exceed \$209 million from January 1, 2015 until six days before the IMF Executive Board meeting. The computation of CBA net sales will include CBA outright net sales via the following channels: Nasdaq-OMX platform, auctions, and the interbank market. However, the computation of net sales may also include CBA net sales in other markets or instruments that the CBA may choose to substitute for outright net sales (e.g., transactions in derivatives). Transactions of the CBA with the Government or other private or public agencies in the context of budget operations of the Government are not considered net sales (unless they take place through one of the channels mentioned above). In this respect, purchases of the foreign currency proceeds of the Eurobond or other official financing will not be interpreted as CBA purchases of foreign exchange for the computation of the CBA net sales total.	Sales amount to \$195.5 million through October 14.
2. Approval by parliament of legislation to (i) introduce an excise tax on compressed natural gas (CNG) in the amount of AMD 8,330 per 1000 cubic meters, (ii) set the sum of the excise tax and VAT on gasoline at AMD 120,000 per ton instead of the current AMD 112,000, and the excise tax on diesel fuel at AMD 35,000 per ton instead of the current AMD 32,500 and (iii) increase by 10 percent the excise tax on vodka and tobacco products.	First reading in parliament completed in June; final reading expected in October.

1/ Measures for implementation 6 days before IMF Executive Board consideration of the Second Review (November 6).

Table 3. Armenia. Program Structural Benchmarks

Item	Measure	Time Frame (End of Period)	Status	Comment
Tax administration				
	- Submit to the National Assembly legislative amendments to the customs code to introduce an Authorized Economic Operators (AEO) system, improve the appeals procedures, introduce an advance tariff information system, extend the scope of electronic declaration of goods, and introduce the possibility of postponing the payment by introducing a systems for financial guarantees	March 2014	**Met**	Amendments submitted to the National Assembly in March 2014 and approved in May 2014.
	- Establish a Risk Management Unit (RMU) in the State Revenue Committee (SRC) to develop and implement a modern tax compliance strategy	June 2014	**Met**	Unit was established in February, with functions approved in March. Risk management functions clarified in the newly reorganized MOF-SRC structure in August.
	- SRC Risk Management Unit to prepare a compliance strategy for 2015 and beyond, with comprehensive annual action plans, monitoring, and ex post evaluation of tax payments	December 2014	**Met**	
	- Cabinet to approve a decree with an action plan detailing specific measures to enhance accounting, inventory, and reporting practices of state entities operating in healthcare, natural resource use, energy, education, transport, agriculture, and urban development and construction sectors	December 2014	**Met**	
Tax policy				
	- Prepare a policy paper on strengthening collections from high-wealth individuals (HWI), covering necessary tax policy changes (e.g., dividend and capital gains taxation), revenue administration actions and legal or regulatory changes (risk and compliance profiles and audit), and the institutional set- up	September 2014	**Met**	Authorities provided a draft paper to the Fund staff, including a review of policies and practices in European countries and the region.
	- Submit to cabinet specific proposals to strengthen collections from high-wealth individuals (capital gains, dividends, property taxation, audit), along with estimated revenue effects, to be included in the new tax code	June 2015	**Met**	Discussion note submitted to Cabinet. However, it did not involve specific proposals (timing, required steps, possible yields).
Public Financial Management				
	- Establish a fiscal risk management unit at the Ministry of Finance that analyzes and manages fiscal risks related to concessions, regulated utilities, state-owned enterprises (notwithstanding the extent of state shareholding or line-ministry affiliation), and PPPs in an integrated manner	December 2014	**Met**	Fiscal Risk Assessment division established by ministerial order on 12/20/2014. Unit is functioning and has received FAD TA.
	- Submit to the Office of the Prime Minister an analysis of the reasons for underexecution of the capital budget, with proposals of how to increase capital budget execution	April 2015	**Met**	Analysis completed with government decree on accountability of the project implementation units adopted (N-884-N). Seminar for IFIs and others on reasons for underexecution. Implementation has improved in 2015.
Financial sector				
	- Issue regulations to require banks to set minimum capital requirements for common equity and Tier 1 capital according to the Basel III recommendations, and prepare the methodology on identifying domestic systemically important banking institutions (SIBIs)	June 2014	**Met**	Regulations and methodology approved in June 2014.
	- Prepare a policy paper with stakeholders on legal, regulatory, and institutional changes to simplify registration and execution of collateral	June 2014	**Met**	Authorities provided a draft paper to the Fund staff. Follow-up steps being taken.
	- Submit to National Assembly legislation to shorten the depositor pay-out period of the DGF	September 2014	**Met**	Draft legislation submitted to the National Assembly. Expected to be considered by National Assembly in Fall 2015 session (September-October 2015).
	- Submit to the National Assembly an amendment to the securities law to facilitate access of foreign participants in Armenia's capital market, bringing the framework in line with international standards	September 2014	**Met**	Draft legislation submitted to the National Assembly. Not yet considered by National Assembly.
	- Amend in a manner consistent with the 2012 FSAP Update recommendations the regulation on the calculation of large exposures to align it to international best practices in the areas of (i) weight of exposures to banks and sovereigns, and (ii) consideration of collateral	December 2014	**Dropped**	Benchmark was superseded by more recent Basel III recommendations, which are in line with CBA current practices.
	- Prepare a policy paper assessing CBA's liquidity and reserve requirement regulations, including their levels and currency of denomination, impacts on interest rates, bank liquidity and buffers, and dollarization, compliance with new Basel III recommendations, and exploring the scope for change	March 2015	**Met**	Authorities provided paper to the Fund staff.
	- Submit to National Assembly legislative changes to address the main obstacles hindering registration and execution of collateral	September 2015	**Not met**	Met with delay. Package of legal changes (civil code, criminal code, enforcement of court decisions, real estate appraisal, registration) was approved on October 1 and will be sent to the National Assembly.

Table 3. Armenia. Program Structural Benchmarks (concluded)

Item	Measure	Time Frame (End of Period)	Status	Comment
Central Bank Operations				
	- CBA to publish an annex describing investments in enterprises that are engaged in financial sector development and infrastructure activities in its annual report covering the rationale for these investments , along with objectives, development strategy, enterprise risks, and risk mitigation efforts, and where appropriate, the CBA's divestment strategy	June 2015	**Met**	Consolidated and individual financial statements were included in the CBA's 2014 Annual Report. Further work on risks and possible divestment strategies is needed.
Regulatory and competition policy				
	- Submit to the National Assembly a new draft law on inspection and inspection agencies, for introduction of risk based inspection, maximization of the automation, and elimination of the overlaps by reducing agencies	March 2014	**Not met**	Met with delay. Draft law was submitted to the National Assembly in October 2014 and adopted by the parliament on December 17, 2014.
	- Submit to the Cabinet a plan to restructure the Directorate General for Civil Aviation and establish the new set-up for moving towards open skies	April 2014	**Met**	
	- Submit to the National Assembly six Regulatory Guillotine legislative packages, covering entrepreneurship, tax, customs, social issues, foreign affairs and international relations, and culture, in addition to completion of packets in 2012-13	June 2014	**Not Met**	Met with delay. Legal packages were prepared, and discussed within governmental bodies and ministries. The process of preparation and submission was negatively impacted by the government change. After the new govenrment was formed, the legal package was dicussed again with the new officials in charge. Taking into account all suggestions, the drafts of the legal packages were discussed and approved by Cabinet.
	- Map the entire bankruptcy process to identify the obstacles and gaps that need to be addressed by changes in the legislation	June 2014	**Met**	MOJ completed the mapping, which was submitted to the MOE for comments and assessment of further actions.
	- Put in place memoranda of cooperation between the SCPEC and the SRC, the Economic Crimes Unit of the National Police, and the Office of the Public Prosecutor, covering investigative subpoena, and "dawn raid" operations, information required by the SCPEC, and participation by SCPEC staff in on-site examinations	June 2014	**Dropped**	A previously-existing decree for information exchange by government agencies can provide legal framework for collaboration envisaged in the envisaged memorandum of cooperation.
	- Submit to Cabinet draft legislation to (i) further improve the specialization in the examination of bankruptcy cases at courts; (ii) bring procedures in line with the international best practices; and (iii) increase the number and qualifications of bankruptcy administrators	June 2015	**Not met**	In progress. Concept paper approved by cabinet. The final draft of the legal amendments were submitted ot the government for review. The legal acts are planned to be adopted by the National Assembly in the first half of 2016.
Energy				
	- Issue a study of policy options (energy efficiency investments, tariffs, and targeted protection for vulnerable groups)	December 2014	**Not Met**	Met with delay. The Energy Ministry did not prepare study in time, but work is proceeding on the basis of a May 2015 strategy for 2016-36, with closer cooperation with the World Bank on energy sector financial rehabilitation.

Table 4. Armenia. Proposed New Structural Benchmarks

Area		Measure	Time Frame (End of Period)
Public Financial Management	1	Publish regular consolidated statements across all budget domestic lending programs	December 2015
	2	Complete review of budgetary lending operations to identify risks and management improvements	June 2016
Tax Policy	3	Secure parliamentary approval of further excise tax rate increases from 2017 to bring gradually them in line with rates in other EEU member countries	March 2016
	4	Submit to the National Assembly final proposed tax code containing reduction/elimination of exemptions (VAT, income tax) and of other tax policy gaps (sectoral coverage, tax types) to deliver revenue gains.	March 2016
Energy Sector	5	Adopt by Cabinet of energy sector financial recovery plan involving new loans from IFIs to restructure expensive short-term debt; agreement on a repayment plan for accumulated debt to energy suppliers; a trict prohibition on expenses, borrowing and lending by energy companies outside of their core mandate; tariff adjustments, where needed; and a new tariff mechanism to more quickly transfer the risk of deviations from the planned energy-generation mix to consumers, in line with best international practices	March 2016

Attachment I. Technical Memorandum of Understanding

1. This memorandum sets out understandings between the Armenian authorities and the IMF staff regarding the definition of performance criteria (PCs) and indicative targets (ITs), adjusters, and data reporting requirements for the Extended Arrangement as per the Letter of Intent and Memorandum of Economic and Financial Policies (LOI/MEFP) dated October 22, 2015, and previous letters of intent dated February 17, 2014 and December 3, 2014.

2. For program monitoring purposes, all foreign currency-related assets, liabilities, and flows in the monetary accounts will be evaluated at program exchange rates. The program exchange rate of the Armenian dram to the U.S. dollar is set at 410 dram per one U.S. dollar. The cross-rates for other foreign currencies are provided in Table 1.

Quantitative Targets

3. The program sets PCs and ITs for defined test dates (see Table 1 in the LOI/MEFP). The program sets the following PCs:

- Floor on the net official international reserves (NIR) of the Central Bank of Armenia (CBA);
- Ceiling on the net domestic assets (NDA) of the CBA;
- Ceiling on external public debt arrears (continuous);
- Floor on the program fiscal balance;
- Ceiling on domestic budgetary lending; and,
- Ceiling on absorption of losses or liabilities and making of payments on behalf of utilities and other companies (continuous).

The program sets the following ITs:

- Headline inflation;
- Floor on average concessionality of newly contracted external debt;
- Ceiling on new government guaranteed external debt; and,
- Floor on social spending of the government.

4. **The net official international reserves** (NIR) (stock) of the Central Bank of Armenia (CBA) will be calculated as the difference between total gross official international reserves (excluding commercial bank required and excess reserves at CBA in FX) and gross official reserve liabilities.

- Gross official international reserves are defined as the CBA's holdings of monetary gold (excluding amounts pledged as collateral), holdings of Special Drawing Rights (SDRs), including the August 28, 2009 General Allocation and the September 9, 2009 Special Allocation, the country's reserve position at the IMF, and holdings of convertible currencies in cash or in nonresident financial institutions (deposits, securities, or other financial instruments). [1] Gross reserves held in the form of securities and other financial instruments are marked to market. Excluded from gross reserves are the balance on the government's Special Privatization Account (SPA), capital subscriptions in foreign financial institutions and illiquid foreign assets, any assets that are pledged, collateralized, or otherwise encumbered, claims on residents, claims in foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options), precious metals other than gold, assets in nonconvertible currencies, and illiquid assets.

- Official reserve liabilities shall be defined as the total outstanding liabilities of the government and the CBA to the IMF and convertible currency liabilities of the CBA to nonresidents with an original maturity of up to and including one year, as well as commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options).

NIR is monitored in U.S. dollars, and, for program monitoring purposes, assets and liabilities in convertible currencies other than the U.S. dollar shall be converted into dollar-equivalent values using the convertible exchange rates as specified in Table 1.

5. **Headline inflation** is defined as the year-on-year rate of change of the Consumer Price Index as measured by Armenia's National Statistics Service. The indicative target will be considered met if headline inflation falls within a range of +/- 1½ percentage point around the mid-point target.

6. **Net domestic assets** are defined as reserve money minus NIR, minus other assets not included in gross official international reserves, minus commercial bank required and excess reserves at CBA in FX, plus medium and long-term foreign liabilities (i.e., liabilities with a maturity of one year or more) of the CBA, plus other foreign liabilities not included in official reserve liabilities, minus the balance of outstanding Fund purchases credited to the government account at the CBA. NDA is composed of net CBA credit to the general government plus outstanding credit to domestic banks by the CBA (including overdrafts) minus liabilities not included in reserve money and other items net. The ceiling will be considered as met if the outcome is within AMD 15 billion of the targets sets in Table 1 attached to the LOI/MEFP.

[1] Convertible currencies are limited to: U.S. dollar, U.K. pound, euro, Japanese yen, SDR, Australian dollar, Canadian dollar, and Swiss franc.

7. **External public debt arrears** are defined as all unpaid debt-service obligations (i.e., payments of principal and interest) arising in respect of public sector loans contracted or guaranteed to non-residents, including unpaid penalties or interest charges associated with these obligations that are overdue beyond 30 days after the due date.[2] The ceiling on external payment arrears is set at zero.

8. **The program fiscal balance** is cumulative from the beginning of the fiscal year and is measured from the financing side as the negative of the sum of net domestic banking system credit to the central government, net domestic nonbank financing, and net external financing to the central government. Should a general subsidy or any other fiscal transaction be introduced off-budget, the overall balance will be measured including the subsidy and other fiscal transactions as part of government spending.

- **Net banking system credit to the central government** equals the change during the period of net credit to the central government.

- **Net nonbank financing** equals the sum of: (1) the change during the period of outstanding treasury bills and bonds to nonbanks (including accrued interest for treasury bills and excluding accrued interest for treasury bonds);[3] (2) any other disbursement or transaction that increases nonbanks' claims on the central government plus withdrawals from the Special Privatization Account (SPA) or the treasury sub-account containing privatization proceeds in drams, less amortization paid by the central government to private resident nonbank agents.

- **Net external financing** equals total debt-increasing disbursements from non-residents to the central government (including Fund net purchases credited directly to the government accounts at the CBA) less total amortization from the central government to non-residents. Net external financing also includes any privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **A budgetary ER** of 411 drams per one US dollar will be used for foreign currency-denominated transactions included in the 2015 budget with the exception of the amounts received for project implementation units (PIU) for which the prevailing ER at the time of the transaction will be used. Proceeds from the March 2015 Eurobond issuance and related coupon payments in 2015 will be valued at the ER of March 30, 2015. Any additional unbudgeted transactions for 2015 will take place at the market exchange rate. Under the existing budgetary ER framework arrangement, for 2016, the ER stated in the Budgetary Address (ER of the Draft Budgetary Law in case the state budget is not approved by the Parliament) will be used for foreign currency-

[2] The public sector is here defined following the *Government Financial Statistics Manual* (GFS 2001) and *System of National Accounts* (1993 SNA). It includes the general government and nonfinancial public enterprises (as defined in paragraph 14).

[3] Domestic nonbank holdings of treasury bills and treasury bonds are defined as total outstanding treasury bills and bonds less holdings by the banking system and the State Fund for Social Insurance.

denominated transactions included in the 2016 budget, with the exception of the amounts received for PIU for which the prevailing ER at the time of the transaction will be used. In addition, if new foreign currency-denominated transactions are introduced at any time, these will take place at the prevailing ER at the time of the transaction. The framework arrangement will not be modified (in substance), but may be clarified as this would imply noncompliance with the program continuous PC on ER arrangements and multiple-currency practices.

9. External and domestic net lending, which are recorded as financing items, are *excluded* from the calculation of the program fiscal balance. This effectively treats net lending as an expenditure item when loans are made and as a revenue item when the loans are repaid.

10. Transactions related to the extension of the operating life of the Metsamor nuclear power station—which will take place via lending from the Russian Federation to the Ministry of Finance of Armenia and from the MOF of Armenia to the Armenian Nuclear Power Plant JSC—will be excluded from the measure of the program fiscal deficit.

11. Some project implementation units maintain accounts at the CBA. Grants received by these units are recorded in the fiscal accounts as external grants on the revenue side and as foreign-financed expenditure on the expenditure side. In addition, any loans to finance investments that are intermediated through the banking system are recorded in the financial accounts as a financing item below the line and are thus excluded from net lending. Under previous Technical Memoranda of Understanding, these activities were excluded from the calculation of the program fiscal balance. This treatment reflected lags in receiving information from project implementation units and on project loans intermediated through the banking system. With the shift to semi-annual program reviews with the arrangements under the previous Fund-supported program and consolidation of the accounts of these units in the Treasury, there is no longer a need for such exclusion, and these activities are now fully accounted for in the program fiscal balance.

12. Foreign currency proceeds from selling enterprises are credited to the SPA and their use is reflected in the state budget. In addition, the Government will ensure full transparency of revenues and spending from the sales of major assets (beyond regular day-to-day operations) of enterprises with state ownership. This will include presentation of use of funds from the sale of the hydroelectric assets of the Vorotan Cascade Company, including for electricity subsidies and payment of wage arrears of Nairit. The SPA is held at the CBA and the proceeds are invested abroad together with the CBA's international reserves. These proceeds are included in the definition of the monetary accounts of the CBA as part of net foreign assets with a counter entry in other items net. Any withdrawal from the SPA will be accounted for as privatization proceeds used to finance the budget and will be recorded below the line. Domestic currency proceeds from selling enterprises to residents are deposited in a sub-account of the treasury single account and are also treated as a financing item and recorded below the line. Finally, as noted in ¶8, privatization proceeds received from non-residents in foreign currency and not held in the SPA are also treated as a financing item (sale of financial assets) and recorded below the line.

13. Domestic budgetary lending is defined as the gross amount of new loans made to resident individuals, enterprises, or entities financed from the state budget or other general government resources. This includes, but is not limited to, loans financed from the Economic Stabilization Fund and lending under existing or prospective government programs, such as agricultural sector support and real estate development programs, among others.

14. Absorption of losses or liabilities and making of payments on behalf of utilities and other companies. The program sets a continuous ceiling on absorption by the public sector of losses or liabilities from outside the budgetary sector. The public sector is defined as institutions covering the state budget and state debt—including the central and local governments—plus the CBA and enterprises or other entities with state ownership or control. Absorption of losses or liabilities is defined as direct payment by the public sector of the losses or liabilities of other parties or coverage of losses or liabilities by other transactions, such as debt-for-equity swaps or a write-off of tax obligations or other state claims. The ceiling is set at zero, and excludes AMD 13.7 billion, (approximately $33 million) of subsidies in the 2015 budget for Yerevan Metro, Yerevan Electric Transport, Irrigations Systems, Armenian Water and Sanitation, Nor Akunk, Lori Water and Sanitation, Shirak Water and Sanitation, and irrigation water intake entities. For 2016, the ceiling will exclude subsidies to these same entities of not more than AMD 16.1 billion. The ceiling will also exclude government support for the electricity tariff differential, which should not exceed $12 million. During the program period, there may be occasions when absorption of a limited amount of losses or liabilities, or making limited payments on behalf of utilities or other companies would facilitate a positive outcome (e.g., a major foreign investment transaction, poverty alleviation or equity enhancement, or prevention of even greater losses that would endanger financial stability). The PC will be considered to be met, if new subsidy amounts do not exceed AMD 2.5 billion. In the case of new subsidies, the Armenian authorities will discuss the circumstances and possible options with the Fund staff prior to transactions more than AMD 500 million. Any modification of the PC to make any such payments or absorb any losses will require approval by the IMF Executive Board, at the time of the text review.

15. Floor on average concessionality of newly contracted external debt. The program sets an annual indicative floor of 30 percent on the average concessionality of new debt on a contraction basis with nonresidents with original maturities of one year or more as contracted and guaranteed by the public sector. The concessionality floor is calculated on a calendar-year basis.

- The grant element is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rate used for this purpose is a unified discount rate set at 5 percent.

- The public sector here comprises the general government (central, plus local governments and covering the state budget and state debt), the central bank, and nonfinancial public enterprises (enterprises and agencies in which the government holds a controlling stake—typically owns more than 50 percent of the shares, but which are not consolidated in the budget).

- For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or from any implicit legal or contractual obligation of the public sector to finance partially or in full any shortfall incurred by the debtor.

16. Ceiling on government guaranteed external debt. In addition to the indicative floor on average concessionality, a separate, cumulative ceiling (IT) of $50 million for the program period applies to new government guarantees of the total of concessional and non-concessional external financing. The issuance of debt guarantees will be measured at the exchange rates listed in Table 1. The above limit covers debt guarantees issued by the general government to entities outside the general government (excluding the CBA). Guarantee issuance will be monitored on a monthly basis and the Ministry of Finance will provide data within 21 days from the end of the month.

17. The program sets a floor on **social spending of the government**. For the purposes of the program, social spending of the government is defined as 95 percent of the budgeted amount of the family benefit program and lump-sum financial aid, one-time childbirth benefits, and childcare benefits for children less than two years of age.

18. The quantitative performance criteria and indicative targets under the program are subject to the following **adjusters**, calculated, where relevant, using program exchange rates:

- **Changes in reserve requirements**: The ceiling on the NDA of the CBA will be adjusted downward (upward) by the amount of banks' reserves freed (seized) by any reduction (increase) of the reserve requirement ratio on both domestic currency and foreign currency liabilities relative to the baseline assumption as per the following formula: $\Delta NDA = \Delta rB$, where B denotes the level of liabilities subject to reserve requirements in the initial definition and Δr is the change in the reserve requirement ratio.

- **KfW, Asian Development Bank, and World Bank loan disbursements**: the ceiling on the NDA of the CBA will be adjusted upward (downward) by the full amount of any excess (shortfall) of disbursements from the KfW, Asian Development Bank, and World Bank loans directed at SME financing compared to programmed amounts (Table 2). The floor on NIR will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of these disbursements compared to program amounts.

- **Budget support grants to the public sector** are defined as grants received by the general government for direct budget support from external donors and not related to project financing.

- **Budget support loans to the public sector** are defined as disbursements of commercial loans (e.g., Eurobonds), loans from bilateral and multilateral donors for budget support, and Fund purchases credited directly to the government accounts at the CBA.

- **Project financing to the public sector** is defined as disbursements of loans from bilateral and multilateral donors for public sector projects.

- **The floor on NIR** will be adjusted upward (downward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants (excluding Fund purchases by the government) compared to program amounts (Table 3). The floor on NIR will be adjusted downward for any external public debt amortization amounts in excess of program amounts. The floor on NIR will be adjusted upwards by the amount of any funds received in respect of deposits held at the Inter State Bank as well as for privatization proceeds received from non-residents in foreign currency and not held in the SPA.

- **The ceiling on NDA** will be adjusted downward (upward) by the cumulative amount of any excess (shortfall) of budget support loans or budget support grants compared to program amounts (Table 3).

- **The floor on the program fiscal balance on a cash basis** will be adjusted upward (downward) by the cumulative total amount of the budget support grants received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $50 million per year in either direction. The floor on the program fiscal balance on a cash basis will also be adjusted downward (upward) by the cumulative total amount of the project financing received in excess (to account for a shortfall) of the program amounts (Table 3), subject to a cap of $50 million in either direction.

- **The ceiling on domestic budgetary lending** will be adjusted upward by the amount of undisbursed funds under domestic budgetary lending programs approved in the previous year.

B. Data Reporting

19. The government and the CBA will provide the IMF the information specified in the following table.

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
CBA	CBA balance sheet	Summary	Daily	The following working day
	CBA balance sheet	Summary at program exchange rates; and by chart of accounts at actual official exchange rates	Monthly	Within seven days of the end of each month
	Monetary survey	Summary banking system balance sheet for the central bank at both program exchange rates and by chart of accounts at actual official exchange rates; the consolidated balance sheet of commercial banks by chart of accounts at actual official exchange rates	Monthly	Within 25 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
	International reserves	By chart of accounts; at (i) program exchange rates; and (ii) at actual official exchange rates	Daily	The following working day
	Foreign exchange market	Official exchange rates (buying and selling); daily trade volume, and weighted average exchange rate of the interbank, intrabank and Nasdaq-OMX	Daily	Within 1 day
	Foreign exchange market	CBA foreign exchange operations, (exchange rate, volume)	Daily	Within 1 day
	Foreign exchange market	Exchange rate (buying and selling)	Daily	Within 1 day
	Interest rates	Refinance rate	At least monthly	Within 1 days of the CBA Board decision
	Interbank money market	Daily interbank repo volume and interest rate and number of trades	Daily	Within 1 day
	CBA operations	Repo (reverse repo) operations, open market operations, Lombard credits, deposit facility, and foreign exchange swaps (volumes, maturity, yields, exchange rates)	Daily	Within 1 day
	Bank liquidity	Reserves and excess reserves, by currency	Monthly	Within 15 days of the end of each reference period
	Interest rates and flows of the funds attracted and allocated by commercial banks	By currency and maturity	Weekly	Last working day of the week
	T-bill and coupon bond financing, CBA securities	Auction data: date, original and remaining maturities, issuance volume, allocation, average yield and coupon yield (if available)	Weekly	Last working day of the week
	Banking data	Sectoral distribution of loans and deposits; dollarization of loans and deposits; loan maturities; interbank rate, by volume and maturity; T-bill rate, bond yield; deposit and	Monthly	Within 25 days of the end of each month

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		lending rates, by maturity; monthly weighted average interest rate on government bonds		
	Banking indicators	Capital adequacy; asset composition and quality; profitability; liquidity; open FX positions; and compliance with prudential norms	Monthly	Within 30 days of the end of each month
	Banking sector stress tests	Results of stress tests on exchange rate, liquidity, and credit risk	Monthly	Within 30 days of the end of each month
	On-lending via commercial banks	On lending via the CBA and government (from the Russian loan, KfW, WB, ADB, etc.) by type of on-lending projects (including loan disbursements and repayments)	Monthly	Within 10 days of the end of each month.
	CPI	Index of core inflation	Monthly	Within 21 days of the end of each month
	Transfers	Non-commercial transfers of individuals	Monthly	Within 30 of the end of each month
	Other monetary data	IFS format	Monthly	Within 45 days of the end of each month
	Balance of payments	Detailed balance of payments data	Quarterly	Within 60 days of the end of each quarter
Ministry of Finance (MOF)	T-bill and coupon bond financing	By holders, i.e., CBA, resident banks, resident nonbanks, and nonresidents	Monthly	Within 7 days of each month
	External debt	Disbursements and stock of outstanding short-term and contracting or guaranteeing and outstanding stock of medium-and long-term external debt of the government, the CBA, and state-owned companies (by company); any stock of arrears on external debt service and outstanding stock of government guarantees and	Monthly	Within 21 days of the end of each month. For project implementation units, within 21 days of the end of each month (preliminary data) and within 45

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		external arrears		days of the end of each month (final data)
	Revenue collection	Total revenue collected separately by the tax administration and customs administration, including revenue by individual tax, and social contributions	Monthly	Within 7 days of the end of each month
	Domestic expenditure arrears	All unpaid claims outstanding at the end of the month which includes wages, social contributions (including for pensions), family allowances, and amortization and domestic interest payments	Monthly	Within 45 days of the end of each month for government arrears
	Privatization receipts	Balance on the SPA; gross inflows into and outflows from the SPA during the month, specifying the nature of each transaction	Monthly	Within 7 days of the end of each month
	Treasury single account (TSA)	Detailed breakdown of central treasury account, including deposits at the central treasury, community budgets, off budget account, monetization account, state budget account and the Republic correspondent account—flows during the month and end of month stocks.	Monthly	Within 7 days of the end of each month
	Consolidated central government	State budget	Monthly	Within 30 days of the end of each month
	Consolidated general government	Central and local governments, and Non-Commercial Enterprises that belong within the general government (NCEs)	Quarterly	Within 60 days of the end of each quarter
	Consolidated general government	Central and local governments, and NCEs that belong within the general government	Annual	Within 180 days of the end of each year
	Budget execution	All cash receipts, cash expenditures, including domestic and external debt-service payments, external and	Monthly	Within one month following the end of each

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		domestic borrowing and lending operations, and inflow of grants to the central government; expenditure data will be provided according to both economic and functional classifications, consistent with the GFSM2001 methodology		quarter.
	Financial information on utilities and other major companies with a state interest	Profit and loss indicators for regulated utilities, for companies with state shareholding of 50 percent or greater, and for companies with state shareholding of 0–50 percent and annual sales or outstanding liabilities of AMD 10 billion.	Quarterly	Within 60 days of the end of each quarter
	Pension system	Number of participants in the pension second pillar, social payments and funded contributions	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
NSS	Balance of payments	Detailed export and import data (issues that have arisen in 2015 with EEU trade data need to be overcome as soon as possible)	Monthly	Within 28 days of the end of each month
		Detailed export and import data	Quarterly	Within 45 days of the end of each quarter
	CPI	By category	Monthly	Within 5 days of the end of each month
MOF (State Revenue Committee)	Tax arrears	By type of tax	Monthly	Within 30 days of the end of each quarter (monthly data provided on a quarterly basis)
		For or the 30 largest debtors and for all major companies in the energy, water, and irrigation sectors	Quarterly	Within 30 days of the end of each quarter
	Tax credits	Detailed data, by type of tax, of outstanding tax credits for all types	Monthly	Within 45 days of the end of each

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		of tax revenues and by sectors (i.e. Agriculture, Industry, Mining, Construction, Trade and Services), in both net and gross terms		(monthly data provided on a quarterly basis)
	Tax Revenues	Tax Revenue by Economic Sectors (i.e. Agriculture, Industry, Mining, Construction, Trade and Services)	Monthly	Within 45 days of the end of each quarter (monthly data provided on a quarterly basis)
	VAT and turnover tax	Number of registered taxpayers	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	VAT refund claims in arrears	Detailed data on VAT refunds in arrears which include all outstanding VAT refunds that have not been accepted (and refunded), or offset (in full or in part), or rejected (in full or in part) after the 90 day statutory processing period. Number of refund applications processed per month.	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Large taxpayers	Data on the number of taxpayers and amount of taxes managed by the large tax inspectorate	Monthly	Within 45days after the end of each month
	Import data	1. Total value of recorded imports, breaking out raw diamond imports; 2. Total value of non-duty free recorded imports; 3. Number of total transactions involving recorded imports; 4. Number of total transactions involving non-duty free recorded imports 5. Value of recorded imports where customs value was assessed using transaction prices, breaking out raw diamond imports; 6. Value of non-duty free recorded	Quarterly	Within 30 days of the end of each quarter

Reporting Agency	Type of Data	Description of Data	Frequency	Timing
		imports where customs value was assessed using transaction prices; 7. Number of transactions involving recorded imports where customs value was assessed using transaction prices; 8. Number of transactions involving non duty free recorded imports where customs value was assessed using transaction prices		
	Automated VAT refunds	Number of refunds that were processed automatically (share of total refunds); total value of automated and automatic refunds and offsets; average waiting time (days) to receive refund	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)
	Risk-based selection approach	Percentage of selected companies chosen on the basis of risk-based approach, identified revenue from risk-based audits	Monthly	Within 45 days of the end of each month (monthly data provided on a quarterly basis)

Table 1. Armenia: (Program) Exchange Rates of the CBA

(As of July 31, 2013 in U.S. dollars per currency rates)

Country	Drams Per Currency	Dollars Per Currency
Australian dollar	371.95	0.9072
Canadian dollar	398.33	0.9715
Swiss franc	440.91	1.0754
Danish krone	73.06	0.1782
Euro	544.28	1.3275
Pound sterling	627.83	1.5313
Japanese yen	4.18	0.0102
Norwegian krone	69.14	0.1686
Russian ruble	12.47	0.0304
Swedish krone	62.47	0.1524
SDR	621.04	1.5147

Table 2. Armenia: KFW, AsDB, and IBRD SME Loan Disbursements [1 2]

(In millions of U.S. dollars)

Dec-14		Mar-15		Jun-15		Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
EBS/14/18	Proj.	EBS/14/148	Prel.	EBS/14/148	Prel.	Proj.	Prog.	Prog.	Prog.	Prog.	Prog.
98	96	115	116	125	119	167	173	185	193	213	217

1/ Cumulative from end of the previous year.
2/ Adjustors from EBS/14/18 remain the reference for 2014 targets.

Table 3. Armenia: External Disbursements to the Public Sector [1 2]

(In millions of U.S. dollars)

	Dec-14		Mar-15		Jun-15		Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
	EBS/14/18	Proj.	EBS/14/148	Proj.	EBS/14/148	Prog.	Proj.	Prog.	Proj.	Prog.	Prog.	Prog.
Project financing	203	163	28	17	56	66	116	173	45	91	136	182
Budget support loans	466	454	410	742	410	742	742	921	971	971	1,111	1,111
Budget support grants	133	135	135	135	135	135	143	160	160	160	160	175
of which: EU MFA	47	47	47	47	47	47	47	47	47	47	47	47

1/ Budget support cumulative from the end of the previous year. Project financing cumulative during the same year.
2/ Adjustors from EBS/14/18 remain the reference for 2014 targets.

Annex I. Public Debt Sustainability Analysis

Debt sustainability analysis (DSA) using staff's baseline medium-term projections suggests that Armenia's public debt remains sustainable, although risks are elevated; in particular, external debt is a significant source of vulnerability, and the repayment of the 2013 Eurobond in 2020 increases sharply the government's financing needs. Alternative scenarios and stress tests indicate that an adverse growth shock would have the largest impact on debt dynamics and government financing needs.

Background

1. Armenia's public debt increased in 2014, largely due to depreciation of the dram. The gross debt-to-GDP ratio increased from 41 percent in 2013 to 43 percent in 2014 after the dram weakened in Q4 2014. [1] Even though external public debt declined in US dollar terms by about 2 percent, its dram value increased by 15 percent, and its share reached 86 percent of total public debt. Domestic debt increased by about 6 percent during the period.

2. The macroeconomic assumptions underlying the current DSA have changed since the First Review. Spillovers from Russia have affected the Armenian economy through lower exports and remittances and heightened ER volatility. Declining imports have affected negatively budget revenues. GDP growth projections have been revised downwards; growth is expected to be 2.5 percent in 2015, and the medium-term outlook is now less favorable, reflecting both worsening of external demand conditions and domestic supply constraints. Inflation is expected to remain within the authorities' target band, with the ER adjusting moderately to its equilibrium level. The fiscal deficit in 2015 is projected to deteriorate due to weaker revenues, higher domestic lending, and one-off transactions. The primary deficit (including budget lending) is projected to increase to 3.7 percent of GDP in 2015 and to gradually decline thereafter as fiscal consolidation commences.

3. Debt is projected to increase further in 2015 reflecting a new Eurobond and loans from Russia and Eurasian institutions. With deteriorating economic conditions, rising risks to the budget, and low buffers, the government issued a US$500 million, 10-year Eurobond in March. Part of the funding was used to buy back US$200 million of the 2013 Eurobond. Medium-term debt projections also assume disbursements under a $300 million budget support loan from the Eurasian Fund for Stability and Development (formerly the Anti-Crisis Fund), a $200 million loan from Russia earmarked for defense procurement, and a $300 million loan from Russia to extend the life of the Metsamor nuclear power station.

Public DSA results

4. Public debt is expected to remain elevated throughout the projection period.[2] Armenia's public debt ratio would reach 50 percent of GDP in 2016. Debt in percent of GDP is

[1] The update ratios are based on the new GDP series released by NSS.

[2] Part of the increase is driven by the assumed ER depreciation as the dram continues to adjust.

expected to increase further in 2017 and to decline thereafter as improvement in the interest-growth differential and a reduction of the primary deficit reverse the trend. Still, in the period 2016–20, the debt ratio is expected to remain in excess of 50 percent of GDP, an important threshold under the authorities' public debt law. Under the current projections, the share of FX-denominated debt in total debt declines due to a more rapid increase in amortization relative to new disbursements. Gross financing needs are expected to be in the range of 6 to 7 percent of GDP during 2016–2019, rising to over 12 percent of GDP in 2020 when the (remainder of the) 2013 Eurobond matures. The authorities will continue to rely primarily on financing on concessional terms—especially project-related loans from multilateral donors. Domestic financing is expected to remain below 40 percent of total on average over the medium term, with the share of short-term debt gradually decreasing. An improvement in growth prospects and lower fiscal deficits would result in more favorable debt dynamics, whereas a larger depreciation of the dram than envisaged in the baseline would deteriorate the debt ratio, reflecting the large share of FX-denominated public debt.

5. **There is considerable uncertainty about the baseline, as shown in the fan charts.** This reflects high volatility of GDP growth, the primary balance, and interest and exchange rates in the past. Assuming a symmetric distribution whereby upside and downside shocks are equally likely, the public debt-to-GDP ratio could range between 33 and 73 percent (10^{th} to 90^{th} percentile) in 2016. The spread of the distribution widens significantly over the projection horizon with the upper estimate exceeding 90 percent of GDP in 2020. An asymmetric fan chart, which rules out real exchange rate appreciation, suggests that debt could range between 37and 108 percent of GDP (10^{th} to 90^{th} percentile) in the end of the projections period.

6. **Staff's projections have been pessimistic for GDP growth and more in line with comparators for inflation and the primary balance.** Overall, growth forecasts for Armenia have underestimated actual developments with the exception of the crisis in 2009. The median forecasting error for the period 2006–14 is in the 95^{th} percentile, i.e. projections for Armenia were more pessimistic than in 95 percent of the cases. The median errors for inflation and the primary budget balance forecasts are in the 10^{th} and 73^{rd} percentiles, respectively.

Structure of Government Debt
(percent of total)

	Dec-14	Jun-15
By initial maturity		
Short-term	0.7	1.4
Medium-term	8.0	7.0
Long-term	91.3	91.6
By type of interest rate		
Floating	10.9	10.5
Fixed	89.1	89.5

Source: RA Ministry of Finance

7. **Fiscal consolidation under the baseline is realistic.** The headline overall deficit is envisaged to decline by 0.4 percent of GDP in 2016 on account of revenue measures and expenditure restraints. A larger adjustment supported by broader tax reforms is envisaged over 2017–2018 to stabilize debt and put it on a declining path.

8. **The main vulnerabilities are associated with external public debt.** The high share of FX debt and debt held by non-residents is an important risk factor for fiscal sustainability. A further significant depreciation of the exchange rate would deteriorate the debt outlook as indicated by the stress test (see below). However, this risk is mitigated by the fact that over 90 percent of the debt is long-term, mostly provided by official creditors, and at fixed interest rates (see table). The heat map indicates that macro-fiscal shocks can have a significant impact on the debt profile, reflecting the high share of FX government liabilities.

9. **Debt dynamics deteriorate under a scenario based on a constant primary balance.** The paths of public debt and gross financing needs deviate significantly from the baseline under a constant primary balance scenario; the debt ratio approaches 65 percent and financing needs rise to 18 percent of GDP in 2020, underscoring the importance of fiscal adjustment. Under a scenario where key variables are at their historical averages, the debt dynamics are very close to the baseline but the financing needs increase more noticeably.

10. **Stress tests suggest that real GDP growth shocks have the largest impact on debt indicators.** An adverse shock to growth, whereby real GDP contracts by 6.1 percent and 5.5 percent in 2016 and 2017, respectively, causes public debt to increase to over 70 percent of GDP, and public gross financing needs reach 13 percent of GDP by 2017. Stress tests based on the standardized primary balance, real interest and ER shocks trigger smaller responses. A contingent liability shock is also included in light of potential pressures on the financial sector from a rise in NPLs due to ER depreciation and higher interest rates. Quantitatively, the effect on public debt is broadly similar to that of the output growth shock.

11. **Staff analysis reveals that debt remains sustainable but risks have increased.** To stabilize and eventually reduce the public debt level, fiscal consolidation should start as early as 2016. Staff has advised that consolidation focuses on revenue increases—addressing tax policy and revenue administration gaps—rather than on spending cuts to protect growth enhancing social and capital expenditures. In light of the significant uncertainty surrounding projections and the forthcoming sizeable external debt payments at the end of the projection horizon, a prudent debt management policy is needed to ensure that the financing needs of the government are met at minimum cost.

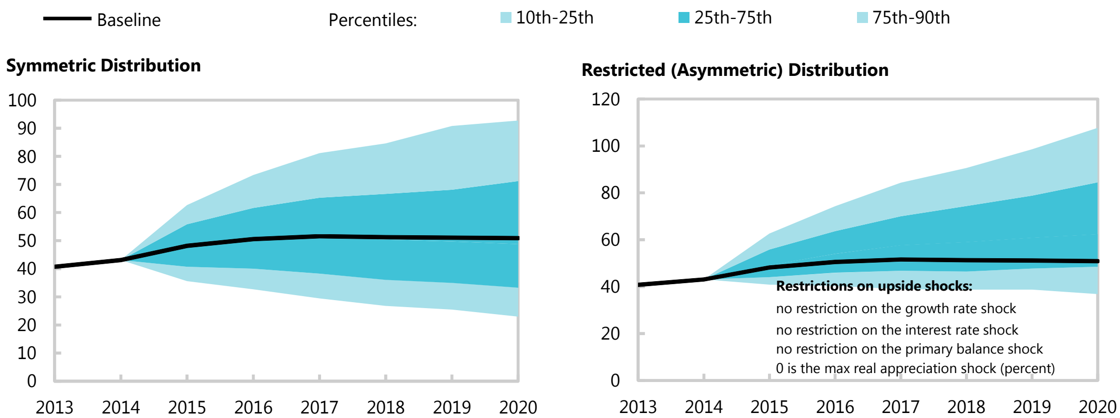
Armenia Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

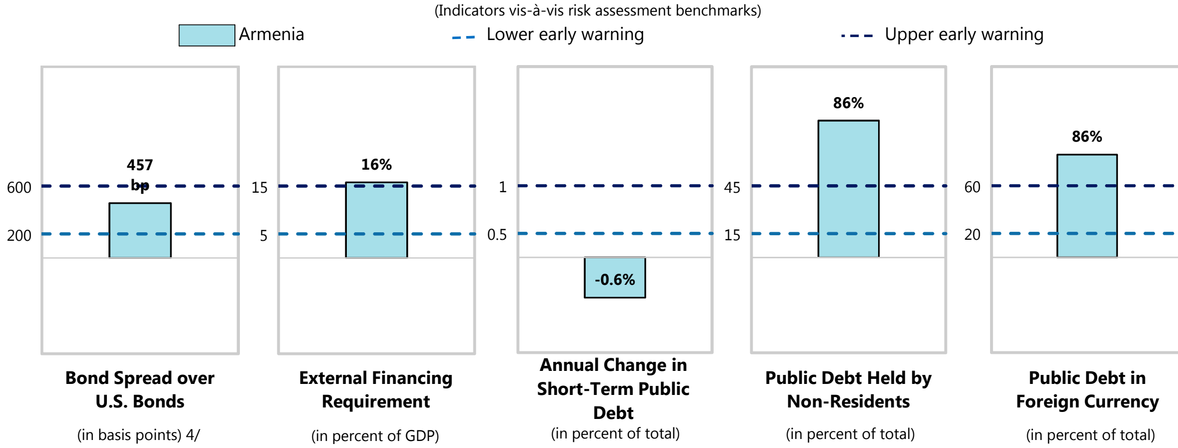
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

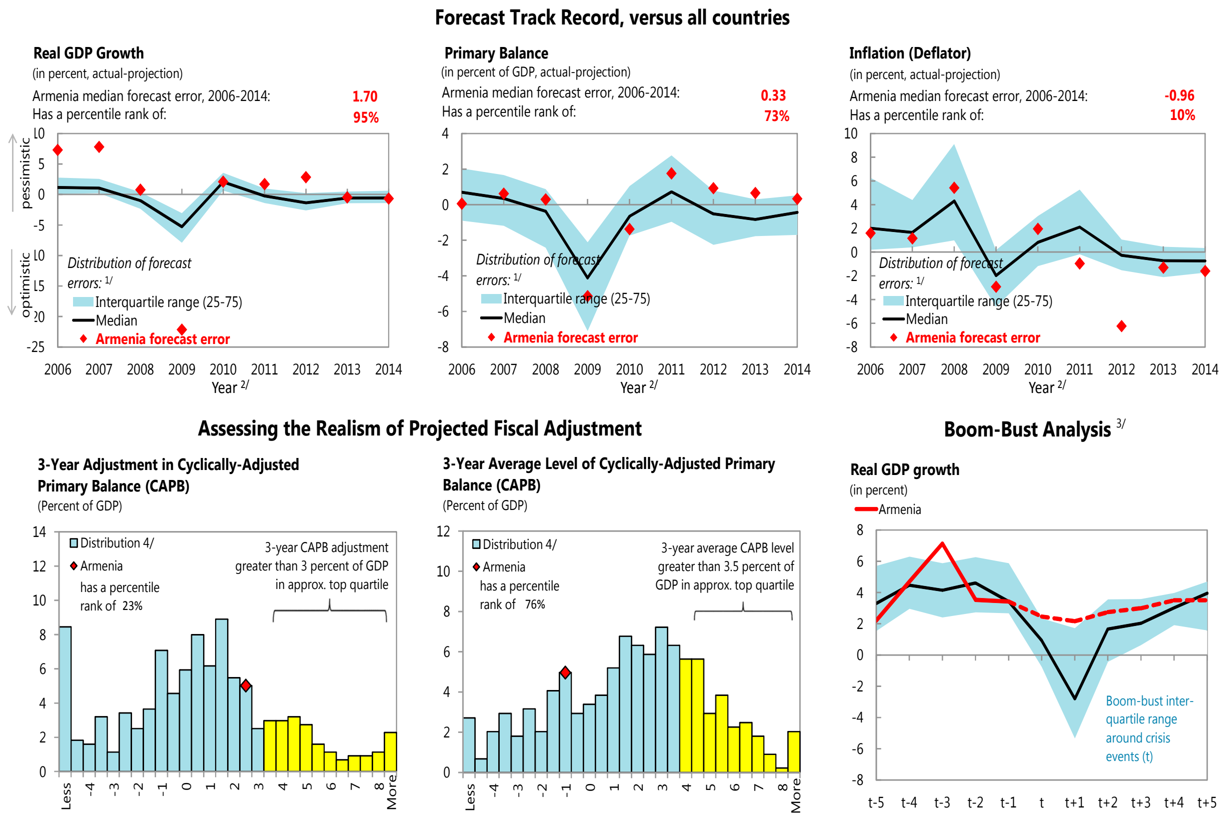
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ An average over the last 3 months, 23-May-15 through 21-Aug-15.

Armenia Public DSA – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Armenia has had a positive output gap for 3 consecutive years, 2012-2014 and a cumulative increase in private sector credit of 11 percent of GDP, 2011-2014. For Armenia, t corresponds to 2015; for the distribution, t corresponds to the fir:

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Armenia Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

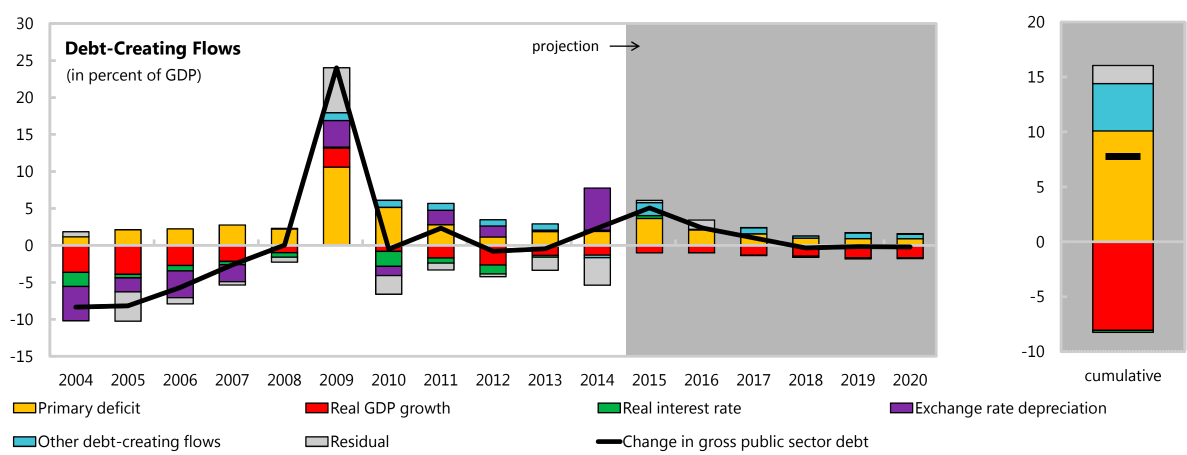
	Actual			Projections					
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	30.1	40.8	43.1	48.2	50.6	51.6	51.3	51.1	50.9
Public gross financing needs	5.7	9.5	5.0	8.9	5.7	6.1	6.4	7.3	12.3
Net public debt		32.4	35.3	40.6	43.9	45.4	45.5	45.7	45.9
Real GDP growth (in percent)	6.5	3.5	3.4	2.5	2.2	2.8	3.0	3.5	3.5
Inflation (GDP deflator, in percent)	4.9	3.1	2.8	3.2	4.0	4.0	4.0	4.0	4.0
Nominal GDP growth (in percent)	11.7	6.8	6.3	5.8	6.3	6.9	7.1	7.6	7.6
Effective interest rate (in percent) [4/]	2.1	2.7	3.3	4.2	4.0	3.9	3.8	3.8	3.9

As of August 21, 2015

Sovereign Spreads		
Spread (bp) 3/	489	
CDS (bp)	n.a.	
Ratings	Foreign	Local
Moody's	Ba3	n.a.
S&Ps	BB-	n.a.
Fitch	B+	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	0.0	-0.45	2.34	5.1	2.4	1.0	-0.3	-0.2	-0.2	7.8	-0.3
Identified debt-creating flows	0.4	1.31	6.08	6.7	2.8	1.8	0.5	0.7	0.6	13.1	
Primary deficit	3.3	1.9	1.9	3.7	2.1	1.6	1.0	0.9	0.9	10.1	
Primary (noninterest) revenue and grants	19.7	22.2	22.0	21.5	21.2	21.8	22.1	22.1	22.2	131.0	
Primary (noninterest) expenditure	23.0	24.1	23.9	25.2	23.3	23.4	23.1	23.0	23.1	141.1	
Automatic debt dynamics [5/]	-3.4	-1.4	4.5	1.3	0.6	-0.5	-0.7	-1.0	-0.9	-1.3	
Interest rate/growth differential [6/]	-2.7	-1.6	-1.1	-0.6	-1.0	-1.4	-1.6	-1.8	-1.8	-8.3	
Of which: real interest rate	-0.9	-0.2	0.2	0.4	0.0	-0.1	-0.1	-0.2	-0.1	-0.2	
Of which: real GDP growth	-1.8	-1.4	-1.3	-1.0	-1.0	-1.3	-1.4	-1.7	-1.7	-8.1	
Exchange rate depreciation [7/]	-0.7	0.2	5.7	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.4	0.9	-0.3	1.8	0.1	0.8	0.3	0.8	0.6	4.3	
Domestic net lend./drawdown of gov. dep. (ne	0.0	0.0	-1.2	0.7	-0.8	0.0	-0.6	-0.1	-0.2	-1.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
External net lending to Nagorno-Karabakh reg	0.4	0.9	0.9	1.1	0.9	0.9	0.9	0.8	0.8	5.3	
Residual, including asset changes [8/]	-0.3	-1.8	-3.7	0.3	1.2	0.0	0.0	0.0	0.1	1.6	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Bond Spread over U.S. Bonds.

4/ Defined as interest payments divided by debt stock at the end of previous year.

5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

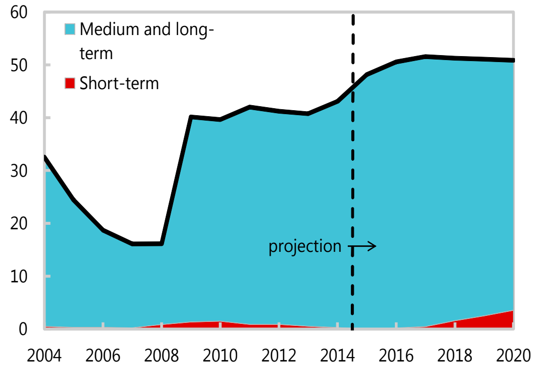
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

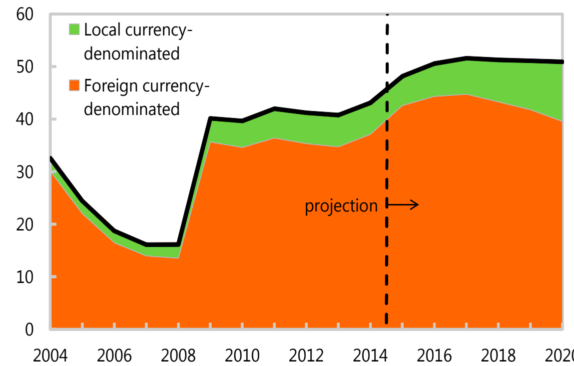
Armenia Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



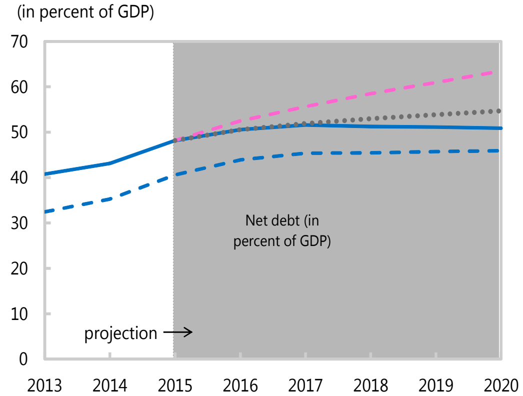
By Currency
(in percent of GDP)



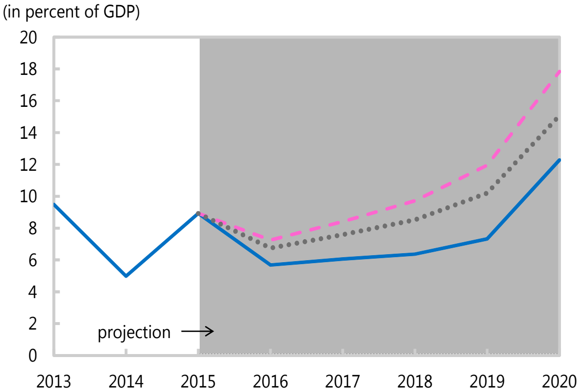
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

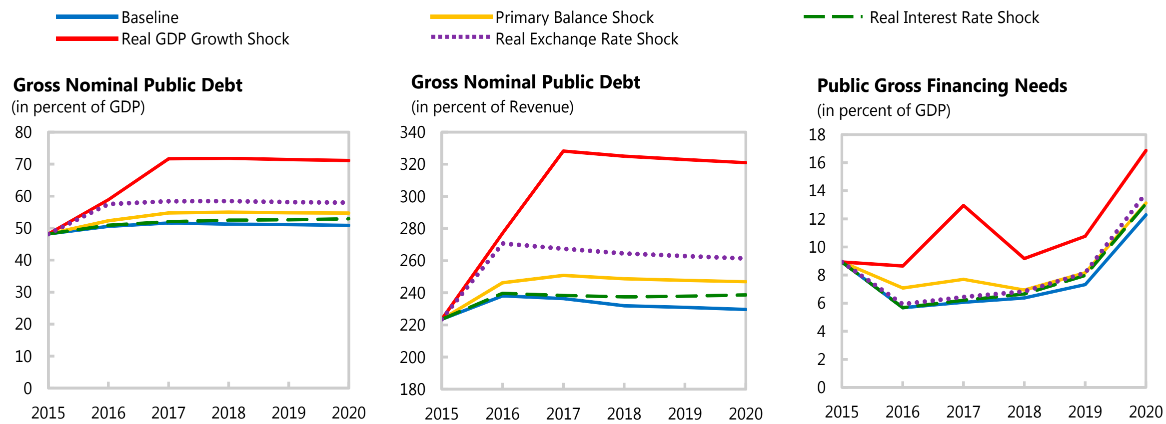
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	2.5	2.2	2.8	3.0	3.5	3.5
Inflation	3.2	4.0	4.0	4.0	4.0	4.0
Primary Balance	-3.7	-2.1	-1.6	-1.0	-0.9	-0.9
Effective interest rate	4.2	4.0	3.9	3.8	3.8	3.9
Constant Primary Balance Scenario						
Real GDP growth	2.5	2.2	2.8	3.0	3.5	3.5
Inflation	3.2	4.0	4.0	4.0	4.0	4.0
Primary Balance	-3.7	-3.7	-3.7	-3.7	-3.7	-3.7
Effective interest rate	4.2	4.0	4.0	3.9	3.8	3.9

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	2.5	5.5	5.5	5.5	5.5	5.5
Inflation	3.2	4.0	4.0	4.0	4.0	4.0
Primary Balance	-3.7	-3.3	-3.3	-3.3	-3.3	-3.3
Effective interest rate	4.2	4.0	3.7	3.3	3.1	3.0

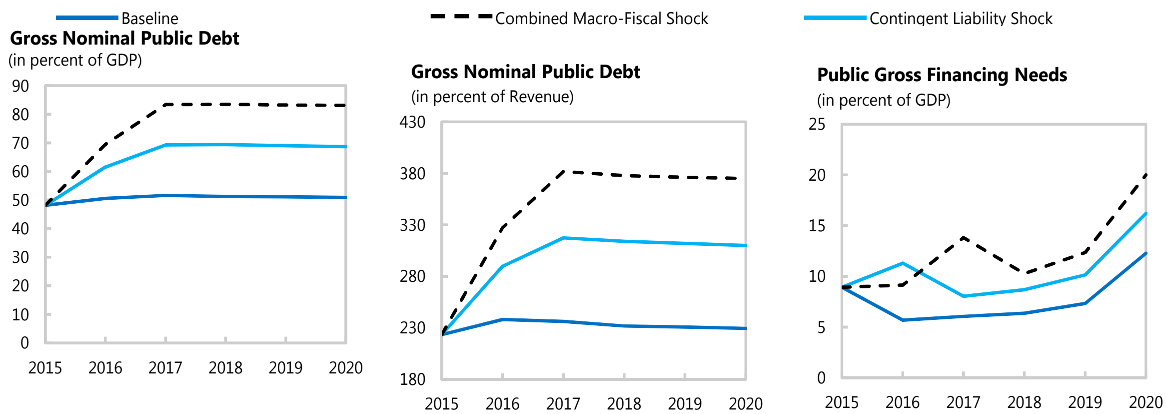
Source: IMF staff.

Armenia Public DSA – Stress Test

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2015	2016	2017	2018	2019	2020
Primary Balance Shock						
Real GDP growth	2.5	2.2	2.8	3.0	3.5	3.5
Inflation	3.2	4.0	4.0	4.0	4.0	4.0
Primary balance	-3.7	-3.5	-2.9	-1.0	-0.9	-0.9
Effective interest rate	4.2	4.0	4.0	3.9	3.9	3.9
Real Interest Rate Shock						
Real GDP growth	2.5	2.2	2.8	3.0	3.5	3.5
Inflation	3.2	4.0	4.0	4.0	4.0	4.0
Primary balance	-3.7	-2.1	-1.6	-1.0	-0.9	-0.9
Effective interest rate	4.2	4.0	4.2	4.3	4.4	4.6
Combined Shock						
Real GDP growth	2.5	-6.1	-5.5	3.0	3.5	3.5
Inflation	3.2	1.9	1.9	4.0	4.0	4.0
Primary balance	-3.7	-4.7	-7.0	-1.0	-0.9	-0.9
Effective interest rate	4.2	4.6	4.1	4.3	4.4	4.6

	2015	2016	2017	2018	2019	2020
Real GDP Growth Shock						
Real GDP growth	2.5	-6.1	-5.5	3.0	3.5	3.5
Inflation	3.2	1.9	1.9	4.0	4.0	4.0
Primary balance	-3.7	-4.7	-7.0	-1.0	-0.9	-0.9
Effective interest rate	4.2	4.0	4.1	4.2	4.1	4.1
Real Exchange Rate Shock						
Real GDP growth	2.5	2.2	2.8	3.0	3.5	3.5
Inflation	3.2	9.6	4.0	4.0	4.0	4.0
Primary balance	-3.7	-2.1	-1.6	-1.0	-0.9	-0.9
Effective interest rate	4.2	4.6	3.8	3.7	3.7	3.8
Contingent Liability Shock						
Real GDP growth	2.5	-6.1	-5.5	3.0	3.5	3.5
Inflation	3.2	1.9	1.9	4.0	4.0	4.0
Primary balance	-3.7	-7.1	-1.6	-1.0	-0.9	-0.9
Effective interest rate	4.2	4.4	4.2	4.1	4.0	4.0

Source: IMF staff.

Annex II. Exchange Rate Assessment, External Debt Sustainability, and Reserve Adequacy

Staff's estimates suggest that with the sizeable improvement of the external current account and higher GDP figures, the dram appears to be close to its equilibrium value. The same factors have also led to improvement in external debt sustainability as well, compared to previous projections. This assessment, however, is sensitive to the sustainability of the recent significant current account adjustment. At the same time, reserves adequacy continues to be below the adequacy level suggested by the Fund's new metric for non-floating exchange rate regimes.

Exchange Rate Assessment

Based on revised BOP projections and historical GDP figures, staff's estimates suggest that the dram is close to its equilibrium level. [1] The extent of misalignment of the real effective ER (REER) is assessed using the IMF's External Balance Approach-lite (EBA-lite)[2] The EBA-lite macrobalance approach suggests a current account norm of –5.8 percent of GDP for 2014, about 1.5 percentage points lower than the actual current account last year. The calculation implies an ER misalignment of about 9 percent at end-2014. With the depreciation of the real effective exchange rate projected for 2015, the dram appears to be near its equilibrium level. The EBA-lite *external sustainability approach* estimates a current account norm for Armenia that stabilizes the ratio of Net Foreign Assets to GDP at its 2014 level (-67 percent of GDP). Comparing the current account norm of this approach (–4.3 percent of GDP) with its medium-term projected value (–5.6 percent) implies a REER overvaluation of 8 percent over the medium term.

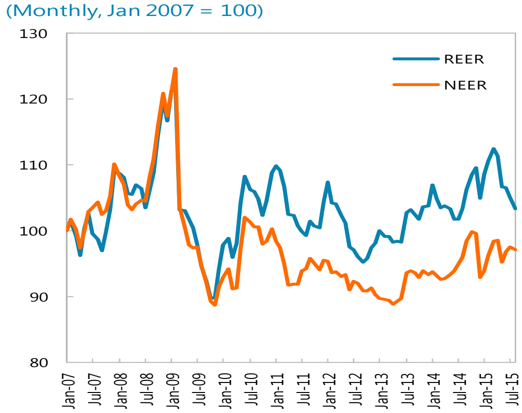
Estimated Real Exchange Rate Misalignment
(In percent of GDP, unless indicated otherwise)

	Macrobalance approach (EBA-lite)	External sustainability (EBA-lite)
Current account norm	-5.8	-4.3
Underlying current account 1/	-7.3	-5.6
CA gap	-1.5	-1.3
Elasticity	-0.16	-0.16
Real exchange rate gap 2/	8.9	7.8

1/ 2014 actual value for the macrobalance approach and 2020 projections for the external sustainability approach.

2/ Movement in real exchange rate needed to close the gap between norm and projection.

Effective Exchange Rates
(Monthly, Jan 2007 = 100)



[1] GDP figures have recently been revised upwards by approximately 7 percent. This, together with a sizeable nominal improvement in the trade balance due to the projected major decline in imports outweighing the projected decline in exports and remittances, resulted an improvement in the current account/GDP path.

[2] See IMF WP/13/272 for details of the EBA-lite methodology. Compared to the earlier CGER methodology, EBA makes a sharper distinction between positive (descriptive) understanding of current accounts and real exchange rates and making normative evaluations. EBA takes into account a much broader set of factors—including policies, cyclical conditions, and global capital market conditions—that may influence the current account and real exchange rate. These methodologies are subject to limitations and are sensitive to assumptions; the results should therefore be viewed with some caution.

With considerable volatility, the CPI-based real effective exchange rate has appreciated moderately between 2012 and Q1-2015, but the recent real depreciation brought it back to the average level for the period since 2007.

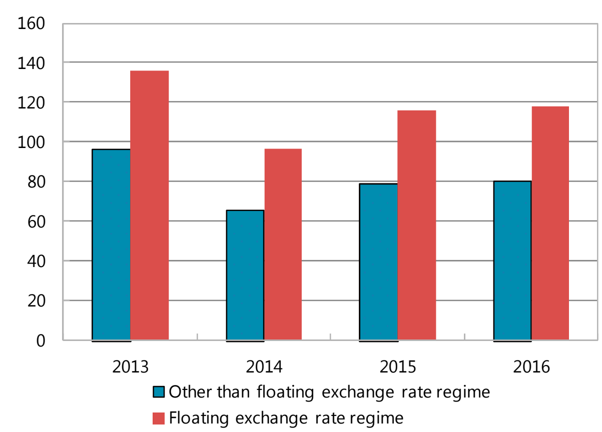
External Debt Sustainability

Armenia's external debt-to-GDP ratio is projected to rise in 2015 but then gradually improve over the medium-term. The ratio was 71.3 percent of GDP at end-2014, and it is projected to rise to around 73.4 percent by 2020 in the baseline scenario. Private sector debt is projected to grow more slowly than public debt in the medium term. The improvement since the last assessment is primarily due to the sizeable improvement in the current account and lower external financing needs. The debt stabilizing non-interest current account deficit is estimated at 4.4 percent of GDP. In the baseline, the change in external debt is dominated by current account deficits (excluding interest payments), which is offset by projected non-debt creating FDI, whereas automatic debt dynamics have a smaller impact.

External sustainability is sensitive to standard shocks other than the nominal interest rate. The external debt ratio increases to 85–88 percent of GDP under standardized shocks to the non-interest current account and growth, as well as under the combined scenario. A one-time 30 percent real ER depreciation would raise the debt ratio by around 30 percentage points above the baseline path to 105 percent of GDP in 2020. Given the large share of concessional financing in external public debt, external sustainability is robust to a standardized shock to the interest rate.

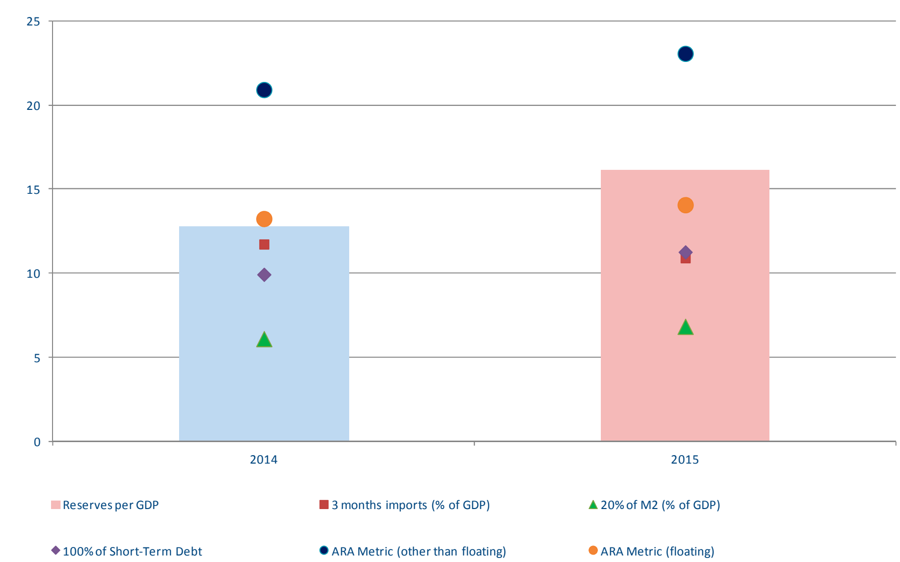
Reserves Adequacy

International Reserves
(In percent of IMF ARA metric)



Following a large drop of reserves in 2014–15 and despite a boost from the March Eurobond issuance and upcoming loans from the Eurasian Fund for Stability and Development, staff projections call into question the adequacy of reserves in the medium term. If a non-floating ER regime (e.g., managed floating with no pre-determined path for the ER) is assumed, the drop in reserves due to interventions in Q4 2014 and 2015 results in significantly less than 100 percent coverage under the IMF's reserve adequacy (ARA) metric from 2014 onwards (reserves are deemed adequate in the 100–150 percent range). Assuming a floating ER regime for the period 2014–2020, reserves adequacy is above 100 percent of the ARA metric in the projection period. However, the past pattern of large-scale FX intervention when ER pressures have arisen calls for consideration of both reserve adequacy ratios, not withstanding staff's advice and the authorities expressed commitment to a flexible ER in the context of their inflation-forecast targeting regime. In addition to the inadequate coverage indicated by the ARA metric for a non-floating ER regime, the high level of dollarization (approximately 70 percent of assets and liabilities) calls for additional FX reserve buffers.

Actual and Projected Reserve Adequacy Indicators, end-year
(as a % of GDP)



Armenia: External Debt Sustainability Framework, 2010–2020

In percent of GDP unless otherwise indicated)

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	**Debt-stabilizing non-interest current account 6/**
1 **Baseline: External debt**	66.4	71.5	70.2	78.7	71.0			**80.5**	**80.5**	**79.5**	**77.6**	**75.6**	**73.4**	**-4.4**
2 Change in external debt	10.0	5.1	-1.3	8.5	-7.7			9.5	0.0	-1.1	-1.9	-2.0	-2.2	
3 Identified external debt-creating flows (4+8+9)	6.1	1.6	1.4	1.0	0.4			-0.2	-0.1	-0.2	-0.3	-0.7	-0.7	
4 Current account deficit, excluding interest payments	12.2	8.5	7.9	5.3	4.1			1.0	1.8	2.3	2.3	2.4	2.3	
5 Deficit in balance of goods and services	25.1	21.5	20.8	19.9	18.5			13.3	13.8	13.7	13.4	13.1	12.6	
6 Exports	23.9	27.0	27.5	28.4	28.5			30.4	30.1	29.6	28.9	28.1	27.6	
7 Imports	49.0	48.5	48.3	48.2	47.0			43.7	44.0	43.3	42.3	41.2	40.2	
8 Net non-debt creating capital inflows (negative)	-3.8	-3.0	-5.4	-3.4	-3.3			-3.1	-4.1	-4.0	-4.0	-3.9	-3.8	
9 Automatic debt dynamics 1/	-2.3	-3.9	-1.1	-0.9	-0.4			2.0	2.2	1.6	1.3	0.9	0.8	
10 Contribution from nominal interest rate	1.4	1.9	2.1	2.3	3.2			3.9	3.9	3.7	3.6	3.4	3.3	
11 Contribution from real GDP growth	-1.2	-2.8	-4.9	-2.4	-2.6			-1.9	-1.7	-2.1	-2.3	-2.6	-2.5	
12 Contribution from price and exchange rate changes 2/	-2.6	-2.9	1.7	-0.8	-1.0			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	3.9	3.5	-2.6	7.5	-8.1			9.7	0.1	-0.9	-1.6	-1.3	-1.5	
External debt-to-exports ratio (in percent)	278.0	264.5	255.5	277.3	248.9			264.7	267.3	268.4	268.6	268.8	265.9	
Gross external financing need (in billions of US dollars) 4/	2.0	2.0	2.7	2.7	2.5			2.2	2.2	2.3	2.4	2.4	3.0	
in percent of GDP	21.2	19.5	25.1	24.1	21.3	10-Year	10-Year	21.1	20.5	20.6	20.3	19.9	23.3	
Scenario with key variables at their historical averages 5/								**80.5**	**74.4**	**69.9**	**65.8**	**62.3**	**58.9**	**-10.8**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	2.2	4.7	7.1	3.5	3.4	5.5	8.2	2.5	2.2	2.8	3.0	3.5	3.5	
GDP deflator in US dollars (change in percent)	4.8	4.6	-2.3	1.2	1.2	7.6	12.2	-11.1	-1.5	1.0	2.0	2.0	1.9	
Nominal external interest rate (in percent)	2.7	3.2	3.1	3.4	4.2	2.8	0.9	5.0	4.9	4.8	4.7	4.7	4.6	
Growth of exports (US dollar terms, in percent)	41.8	24.0	6.4	8.2	5.2	12.7	17.3	-2.8	-0.3	2.0	2.4	2.7	3.5	
Growth of imports (US dollar terms, in percent)	15.6	8.4	4.3	4.6	1.9	13.4	18.6	-15.3	1.3	2.2	2.7	2.7	2.9	
Current account balance, excluding interest payments	-12.2	-8.5	-7.9	-5.3	-4.1	-7.8	4.7	-1.0	-1.8	-2.3	-2.3	-2.4	-2.3	
Net non-debt creating capital inflows	3.8	3.0	5.4	3.4	3.3	5.2	1.9	3.1	4.1	4.0	4.0	3.9	3.8	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

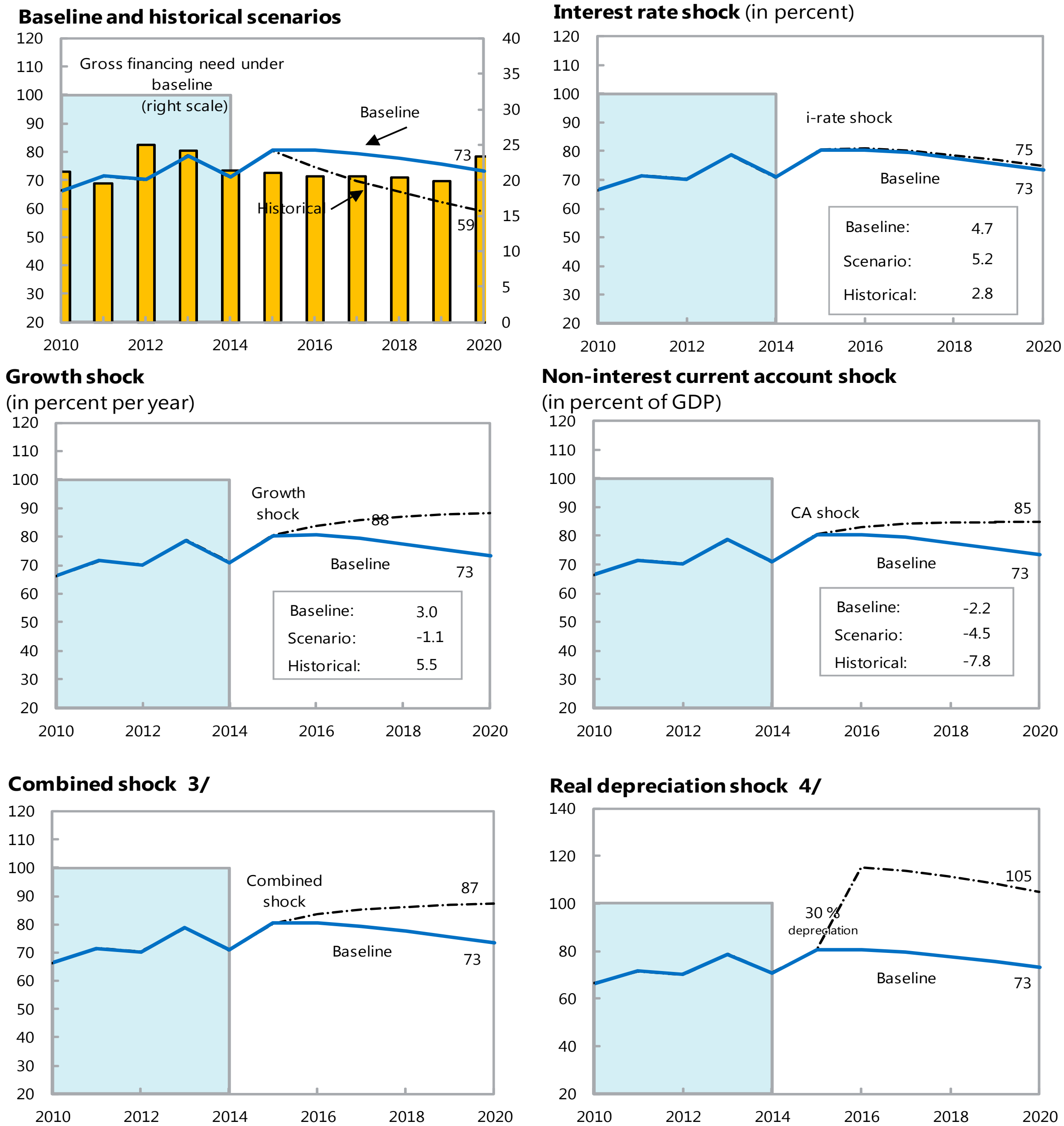
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Armenia: External Debt Sustainability: Bound Tests 1/2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2015.

Annex III. Armenia—Risk Assessment Matrix

Potential Deviations from the Baseline (June 2015 G-RAM) [1]

Nature/source of risk	Relative likelihood	Possible impact if risk is realized	Policy response
Global Risks			
Tighter or more volatile global financial conditions: - Sharp asset price adjustment and decompression of credit spreads, as investors reassess underlying risk and respond to unanticipated changes. - Persistent dollar strength. Improving U.S. economic prospects versus the rest of the world leads to a further dollar surge - Euro area bond market contagion.	**Assessment**: - High - High - Medium	**Staff assessment: Low/Medium** The current account deficit is a source of vulnerability, along with a reversal of bank flows and a significant decline in the FX reserves buffer. Official support mitigates risks.	Increase ER flexibility with intervention only to prevent disorderly conditions and to build buffers. Prepare contingency plans for potential financial spillovers. Enhance monitoring of FX risks.
Risks to energy prices: **- Increased volatility** due to uncertainty about the persistence of the oil supply shock and the underlying drivers of the price decline. **- Persistently low prices** triggered by supply factors reversing only gradually, and weaker demand.	**Assessment**: - Medium - Medium	**Staff assessment: Medium/High** Negative indirect effects through remittance, trade, finance, and investment channels via Russia.	Accelerate reforms to increase growth and diversify export destinations and products. Increase ER flexibility.
Political fragmentation that erodes the globalization process and fosters inefficiency: - **Russia/Ukraine**: the mounting conflict depresses business confidence and heightens risk aversion, amid disturbances in global financial, trade and commodity markets. - **Heightened risk of fragmentation/state failure/security dislocation in the Middle East and some countries in Africa,** leading to a sharp rise in oil prices, with negative global spillovers.	**Assessment**: - Medium - Medium	**Staff assessment: High** Effects would be strong, comprising both direct impacts from Russia and impacts from global disruptions. Tougher sanctions against Russia would lead to more severe impacts, including in the banking sector.	Prepare and implement contingency plans for potential financial spillovers related to regional geopolitical risks.
Structurally weak in key advanced and emerging economies (the "new mediocre") - **Euro area/Japan**. Weak demand and persistently low inflation from a failure to fully address crisis legacies and undertake structural reforms. - **EMs, incl. China**. Maturing of cycle, misallocation of investment, and excess corporate leverage. - **Sharp China slowdown in 2015-16**. Growth falls below target, possibly due to a severe housing downturn or a shock in the shadow banking sector.	**Assessment**: - High - Medium - Medium	**Staff assessment: Medium** Mining exports, an important area for export growth and source of foreign exchange earnings, would be hit hard.	Diversify export destinations and products.
Country-Specific Risks			
Regional conflict: - Risks from sharp, renewed conflict with Azerbaijan over Nagorno-Karabakh - Deterioration of Russian-Georgian relations	**Assessment**: - High - Medium	**Staff assessment: High** - Conflict would involve severe impacts, possibly Russia and Turkey. - Deterioration of Russian-Georgian relations could lead to transport / trade / energy supply disruptions.	Prepare and implement contingency plans.

[1]The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability.

INTERNATIONAL MONETARY FUND

REPUBLIC OF ARMENIA

October 23, 2015

SECOND REVIEW UNDER THE EXTENDED ARRANGEMENT AND REQUEST FOR WAIVERS OF NONOBSERVANCE AND REPHASING—INFORMATIONAL ANNEX

Prepared By

The Middle East and Central Asia Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(September 30, 2015)

Membership Status:
Joined 05/28/1992; Article VIII

General Resources Account:

	SDR Million	Percent of Quota
Quota	92.00	100.00
Fund holdings of currency	244.51	265.77
Reserve Tranche Position	0.00	0.00

SDR Department:

	SDR Million	Percent of Allocation
Net cumulative allocation	87.99	100.00
Holdings	0.29	0.33

Outstanding Purchases and Loans:

	SDR Million	Percent of Quota
ECF Arrangements	141.23	153.51
Extended Arrangements	152.51	165.77

Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	03/07/2014	05/06/2017	82.21	23.48
ECF	06/28/2010	07/02/2013	133.40	133.40
EFF	06/28/2010	06/24/2013	133.40	133.40

Projected Payments to Fund
(SDR million; based on existing use of resources and present holdings of SDRs)

			Forthcoming		
	2015	2016	2017	2018	2019
Principal	5.02	25.29	36.88	45.17	52.83
Charges/interest	0.41	1.59	1.44	1.22	1.16
Total	**5.43**	**26.87**	**38.32**	**46.39**	**53.98**

Safeguards Assessment

An update assessment was concluded in August 2014 with respect to the Extended Credit Arrangement approved in March 2014. According to the update assessment, the Central Bank of the Republic of Armenia (CBA) maintains safeguards in its financial reporting practices, the external audit mechanism, and the internal audit function. The assessment recommended changes to be made in the functioning of governance bodies to ensure the necessary independent and effective oversight of executive functions and audit mechanisms. Following the assessment, the CBA has adopted a charter that outlines the roles and responsibilities of its Board members.

The CBA and MOF have made progress in implementing the recommendations of the most recent Safeguards Assessment, but further work remains. The CBA has adopted a charter for its board members to clarify roles and responsibilities**.** The CBA has investments in enterprises engaged in financial sector development and infrastructure, including a credit card processing company, a mortgage finance company, and a cash collection agency. The CBA has worked with its external auditors to present a consolidated position inclusive of these enterprises and an annex to its annual report describing the rationale for the investments and management of the enterprises. In the future, the annex should cover risks, risk-mitigation efforts, or divestment strategies. Also, pending legislation to provide the CBA with marketable, interest-bearing government securities to cover losses has not advanced in parliament.

Exchange Rate Arrangement

The de jure arrangement is "free floating." The de facto arrangement was reclassified to "floating" from a "stabilized arrangement," effective March 3, 2009. More recently, and following a sequence of interventions to rebuild reserves in the last three quarters of 2013, the de facto exchange rate arrangement has been reclassified from floating to crawl-like arrangement, effective March 12, 2013. This reflected the appreciation of the Armenian dram within a 2 percent band against the U.S. dollar during the last three quarters of 2013.The official exchange rate is quoted daily as a weighted average of the buying and selling rates in the foreign exchange market.

Armenia maintains two multiple currency practices. The first MCP arises from a 2007 agreement between the MOF and CBA to settle some budgetary transactions at an agreed accounting ER throughout the fiscal year. The second The second MCP emerged when the authorities modified the budgetary ER framework in March this year to provide for conversion of funds to make a September 2015 Eurobond coupon payment at a March ER. This constituted a new MCP, as no provision was made to ensure that the September FX purchases under the modification did not deviate from the prevailing ER at the time of the transaction by more than 2 percent. The authorities are requesting a waiver of nonobservance in respect of the second MCP based on the temporary nature of the deviation. However, the authorities are not requesting and staff does not recommend the Board's approval to maintain either MCP.

Armenia maintains no other multiple currency practices or exchange restrictions on the making of payments and transfers for current international transactions except for exchange restrictions maintained for security reasons and notified to the Fund pursuant to Executive Board Decision No. 144-(52/51).

Article IV Consultations

The 2014 Article IV consultation with Armenia was concluded on December 22, 2014. Armenia is subject to a 24-month consultation cycle.

FSAP Participation and ROSCs

A joint World Bank-IMF mission assessed Armenia's financial sector as part of a Financial Sector Assessment Program (FSAP) update during February 1–14, 2012. The Financial Sector Stability Assessment (FSSA) report was approved by the Executive Board in June 2012. The most recent previous FSAP update took place in 2005.

Resident Representative

Ms. Teresa Daban Sanchez, since August 2013.

Technical Assistance

The following table summarizes the Fund's technical assistance (TA) to Armenia since 2010.

Armenia: Technical Assistance from the Fund, 2010–15

Subject	Type of Mission	Timing	Counterpart
Fiscal Affairs Department (FAD)			
Tax administration	Short-term	March –May 2010	MoF, SRC
Tax administration	Short-term	August - November 2010	MoF, SRC
Tax administration	Short-term	September 2010	MoF, SRC
Tax administration	Short-term	November 2010	MoF, SRC
Tax policy	Short-term	February 2011	MoF
Tax administration	Short-term	February–March 2011	MoF, SRC
Tax administration	Short-term	May–June 2011	MoF, SRC
Tax policy (mining)	Short-term	June 2011	MoF
Budget process	Short-term	October 2011	MoF
Public Financial Management	Short-term	November 2012	MoF
Tax Administration	Short-term	April 2013	MoF, SRC
Tax Administration	Short-term	September 2013	MoF, SRC
Fiscal Risk	Short-term	October 2013	MoF, SRC
Tax Administration	Short-term	December 2013	MoF, SRC
Public Finance Management	Short-term	March 2014	MoF
Fiscal Risk	Short-term	November 2014	MoF
Tax administration (LTI)	Short-term	April 2015	MoF
Customs Administration	Short-term	May 2015	MoF
Public Financial Management	Short-term	May-June-September 2015	MoF
Legal Department			
Banking Law	Short-term	June 2011	CBA
AML/CFT	Short-term	Various	MoF
Monetary and Capital Markets Department			
Contingency planning, crisis preparedness	Short-term	March–April 2010	CBA
Workshop on Inflation Targeting (with IMF Research Dept.)	Workshop	April–May 2011	CBA
Bank resolution framework	Short-term	June 2011	CBA
Medium-term debt management strategy	Short-term	December 2011	CBA

Armenia: Technical Assistance from the Fund, 2010–15 (concluded)

FSAP update	Short-term	February 2012	CBA
Inflation targeting (with IMF Research Dept.)	Short-term	February-March 2012	CBA
Inflation targeting	Short-term	November 2012	CBA
Inflation targeting	Short-term	January 2013	CBA
Bank prudential framework	Short-term	April 2013	CBA
Monetary and Foreign Exchange Policy	Short-term	June 2013	CBA
Safeguard Assessment	Short-term	March 2014	CBA
Central Bank Communication	Short-term	April 2014	CBA
Inflation Targeting	Short-term	April 2014	CBA
Inflation Targeting	Short-term	April 2015	CBA
Statistics Department			
National accounts	Short-term	September 2010	NSS
BOP and external debt statistics	Short-term	October 2011	CBA
National accounts	Short-term	April 2012	NSS
Monetary statistics	Short-term	April 2012	CBA
National accounts	Short-term	May 2012	NSS
Monetary statistics	Short-term	October 2012	CBA
Construction Price Index	Short-term	September 2013	NSS

WORLD BANK AND IMF COLLABORATIONS—JMAP IMPLEMENTATION

(As of September 30, 2015)

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
World Bank's Country Partnership Strategy for Armenia (2013-17)	Country Partnership Strategy Performance and Learning Review for Armenia (extending the CPS until 2018)	On-going	December 2015
1. Bank program in the next 12 months	***Selected Ongoing and New Operations*** Public Sector Modernization Project II (US$9m)	Semi Annual	Project Implementation started in Sept. 2010 and closed in January 2017
	Tax Administration Modernization Project (US$12 m)	Semi Annual	WB Board approval July 2012, effective since Dec. 2012, closing date is April 30,, 2016;
	DPO series to support competitiveness and ensure sustainability (US$ 197m)	Quarterly	Board date for DPO-2 ($75 mln) : November 12, 2014 DPO-3 ($50 mln)): November 17, 2015 DPO-4 ($60 mln))– November 2016
	New Health Project for Disease Prevention and Control (US$30m) Public Sector Modernization (III) and PFM project (US$26.5 mln)	Semi Annual	WB Board approved – March 2013 Board Date – Sept. 30 , 2015
	Power Sector Financial Recovery Project ($ 20 mln)	Under-preparation	WB Board Date: February, 2016

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
	Analytic Work Programmatic Poverty work Programmatic Fiscal work (fiscal incidence assessment, public sector wage assessment, review of social assistance programs) PER on Quasi-fiscal activities, Macro-Fiscal sustainability and fiscal Subsidies	Continuous	Annual Series, 2014 report Delivered in June 2014 and Disseminated in November 2014. The 2015 report is due by October 30 2015, dissemination – by December 2015
	New Country Economic Memorandum on Drivers of Dynamism		The 2015 report was finished June 2015, dissemination – in November, 2015
	Assessment of EEU membership on Armenia's economy	Ongoing	Dissemination in October, 2015 (delayed from May, 2015)
	Promoting Productive employment in Armenia – a note on labor market activation		Dissemination in Dec 2014 Policy workshop in December 2014
	Systematic Country Diagnoses (SCD)		Start – January 2016, delivery -June 2017 Closing date – June, 2015
	Selected Technical Assistance IDF grant for guillotine exercise Macro-monitoring		2014-15
	One-stop shop for providing construction permits		March, 2016
	Technical Assistance on Tax Policy ($100K)		Start: July 2015 End: June 2016, Mobilized to support MoF for Tax Code preparation and

Title	Products	Provisional timing of missions	Expected delivery date (tentative)
			discussion,
2. IMF work program in the next 12 months	Third EFF Review Fourth EFF Review **Selected Technical Assistance/Training** FAD (follow-up on customs administration) FAD (Tax policy) FAD (follow-up on Pub. Financial Management) MCM/RES (Inflation targeting)	March 2016 September 2016 TBD TBD TBD September 2015	May 2016 November 2016 TBD TBD TBD October 2015

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

(As of September 28, 2015)

1. **EBRD investments in Armenia reached a record high in 2014**, including €114 million of new investments through 18 projects, a tripling of trade finance to over €50 million. EBRD total commitments at the end of September 2015 were €906 million, with an outstanding portfolio, primarily in the private sector, of €296 million in the power, transport, agribusiness, municipal and infrastructure, manufacturing and services, property, telecommunications, and financial sectors.

2. **The EBRD has been active in municipal infrastructure and urban transport.** During the last 4 years the EBRD has provided nearly €20 million in sovereign loans to achieve the following:

- Within the framework of a second €5 million sovereign loan signed in 2012, support a further rehabilitation program for the Yerevan Metro, including measures to improve environmental impact, energy efficiency, and commercialization, such as elimination of water ingress into the system through energy efficient pumps, development of a modern management information system and signing of a public service contract between the company and the city.

- Construct a new bridge at Bagratashen, to improve transit at the main border crossing between Armenia and Georgia, as part of the EU's Integrated Border Management regional initiative. The EBRD investment amounted to €10.3 million.

- Construct the first EU-compliant solid waste landfill in Armenia. The loan was complemented by capital grant financing of €3.5 million provided by the European Union Neighbourhood Facility and represents the first project under the National Solid Waste Strategy of Armenia.

- Yerevan Street Lighting project (€ 3.6 million) signed in May 2015, will introduce energy efficient lighting technologies in the 28 streets of the City, along with modern control system to serve the wider city during the years to come. This project is an important landmark as it is the first project to benefit an E5P grant facility (€ 1.9 million) since the facility became operational in Armenia in March 2015.

3. **In the financial sector, the Bank has enhanced access to finance, particularly for micro, small, and medium enterprises (MSMEs)**, through an array of dedicated credit lines to commercial banks and micro-credit organizations, direct debt, mezzanine and equity investments, and complementary technical assistance, with a special focus on local currency. Armenia is also one of the countries where the Bank's Local Currency and Capital Markets Development (LC2) Initiative has delivered its best and most visible results, setting the stage for further development of local capital markets.

Notable achievements include:

- Signing 26 deals channelling €155.8 million to Armenian commercial banks and micro financing institutions for on-lending primarily to MSMEs, of which approximately €80 million has been disbursed in local currency, helping reduce vulnerability to exchange rate risk. These credit lines have contributed to over 300,000 MSME loans, totalling €868 million, committed by EBRD partner banks during the strategy period.

- Developing both demand for and supply of energy efficiency investments through credit lines issued under the Caucasian Energy Efficiency Programme (CEEP), and extending its scope beyond corporates to include retail lending. Since 2013, six Armenian banks and one credit organisation have joined the programme, signing more than €30 million in loans for on-lending to industrial and residential EE sub-projects.

- In April 2011, the Bank concluded a memorandum of understanding with the Government to provide technical assistance in a number of areas related to local currency and capital markets development. Consistent progress has been made throughout the strategy period, including enhancement of the Central Bank of Armenia's (CBA) inflation targeting capacity to better anchor monetary policy, partial implementation of a mandatory private pension pillar, and a number of measures designed to reduce dollarization.

- Building on prior efforts to develop the local institutional and regulatory framework, in 2014 the EBRD issued its first bond in Armenian dram, with the proceeds on-lent to MSMEs through dram credit lines in the local banking system. As of September 2015, the Bank had issued €17.8 million equivalent in AMD of local currency bonds, including a AMD 6.75 billion US dollar-settled Eurobond, as well as three smaller AMD issues over the local exchange.

- The Bank has also supported agribusiness and high value-added corporates through direct investment (debt, equity, mezzanine), typically combined with significant hands-on capacity building assistance, helping smaller clients grow their businesses by providing crucial financial and technical support to implement capex intensive business plans. During the last 4 years The Bank has signed 6 deals totalling €9.8 million in support of agribusiness, as well as delivered credit lines and technical assistance to two partner banks for on-lending to micro and small agribusinesses.

4. Through the Small Business Support (SBS) program, the EBRD delivered technical assistance and consulting services to over 1,100 Business Advisory Services (BAS) projects and 50 Enterprise Growth Program (EGP) projects since 2003, helping high quality companies (including a significant number of rural businesses) improve their financial reporting, management capacity and marketing. Within this effort, during the last three years, EGP has provided international expertise to 13 dynamic corporates, which has been particularly effective in helping them design and execute business development strategies. Over the life of the program, nearly 30 per cent of SBS clients secured financing within one year, 57 per cent hired additional employees, and over 91 per cent increased turnover.

5. The EBRD, together with other international financial institutions, supported the creation of the Caucasus Growth Fund in 2012 – the first dedicated fund to provide debt and equity to SMEs in the Caucasus region. Two promising equity investments have already been made in Armenia. Additionally, through the SBS program, the Bank conducted an extensive training-for-trainers course on investor relations and firm-level preparation for private equity.

6. In sustainable energy and mining (in addition to energy efficiency credit lines), the **Bank has signed 3 deals** (including 2 equity investments) totalling €27.4 million. The Bank has:

- Provided a €19 million loan to International Energy Corporation (IEC) for the rehabilitation of seven small hydropower plants of the Sevan-Hrazdan Cascade, a project which also helped bring IEC's technical standards in line with best international practice.

- Signed two equity deals totalling €7.3 million with the Toronto-listed mining company, Lydian International. In addition to these investments, the Bank has engaged in a multi-faceted dialogue with an eye to developing a more comprehensive understanding of international standards, requirements and best practices in the global mining industry in Armenia. Lydian's Amulsar mine project in Armenia was permitted in late 2014; if successful, this project could serve as an important benchmark for the sector, and a positive signal to international investors.

7. Finally, the Bank has coupled these investments with sustained policy dialogue across numerous areas:

- The EBRD-supported Investment Council (IC) has played a positive role in improving the business environment, helping achieve significant regulatory improvements, including a turnover tax regime for small business and approval of a comprehensive risk-based inspection reform. The EBRD has provided material support to the IC Secretariat, thereby helping to provide a platform for dialogue, analysis, problem solving, and decision-making between the private sector and the Government on ways to improve the regulatory framework affecting private sector economic activity.

- In e-Procurement the Bank has assisted the Government by helping prepare the comprehensive legal and regulatory changes needed to make the system EU compliant. E-tendering was launched on January 1, 2014, and other modules are in active states of preparation.

- Finally, the Bank also prepared detailed recommendations in support of an EU compliant telecommunications regulatory framework, although to date implementation by the Government has been limited to number portability.

8. The EBRD's current country strategy was approved in May 2012. The key priorities of the EBRD for the coming three years are: (i) developing the financial sector and improving access to finance; (ii) improving municipal and urban transport infrastructure; (iii) developing agribusiness and high value-added, export-oriented industrial companies; and (iv) improving the regulatory and institutional framework for sustainable energy and increasing value added in the mining sector. The new Country Strategy will be adopted in September 2015.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK (ASDB)

(As of October 1, 2015)

1. **Armenia joined the AsDB in September 2005**, and is currently eligible for financing from AsDB's concessional Asian Development Fund (ADF), as well as its non-concessional Ordinary Capital Resources (OCR). AsDB's first Country Partnership Strategy for Armenia for 2014–2018 (endorsed by AsDB's Board on 27 January 2015) focuses on three sectors: (i) transport, (ii) water supply and other municipal services, and (iii) energy. In August 2014, AsDB's Board approved the reclassification of Armenia for the purpose of access to ordinary capital resources and graduation from the ADF resources, effective January 1, 2017.

2. **As of October 1, 2015, the AsDB cumulative sovereign lending amounted to $797.1 million.** The Seismic Safety Improvement Program ($88.5 million), approved by the AsDB in September 2015, will support the government in seismic strengthening and renovating priority school buildings and in improving seismic safety planning and management competencies.

3. **In 2014 AsDB approved a $37 million loan for the Power Transmission Rehabilitation Project** to help the government diversify energy sources, and rehabilitate and upgrade electricity transmission and distribution networks**.** "Infrastructure Sustainability Support Program" ($49 million) approved in October 2014, will improve road and water service provision through results-based public management and financing reforms. The program will introduce a cross-sector approach, where sector and finance ministries collaborate at all four levels of results-based management—planning, budgeting, implementation, and monitoring.

4. **In 2012 AsDB approved two public sector loans.** The Women's Entrepreneurship Support Sector Development Program, approved in October 2012, promotes gender-inclusive growth by improving the enabling environment and capacity of women entrepreneurs and MSMEs. The program includes two components: (i) a program loan ($20 million) supporting reforms related to improving the business environment for women; and (ii) a financial intermediation loan ($20 million) through the German-Armenian Fund in which medium-term local currency loans will be made by participating financial institutions to MSMEs, with at least 50% of the loans going to women's MSMEs. In 2012, AsDB provided $40 million as additional financing for the Water Sector and Sanitation Sector Project, approved in 2007, for improving access to safe, reliable, and sustainable services in about 29 towns and up to 160 project villages, managed on commercial principles and with environmentally sound practices.

5. **In 2011, ADB approved a $400 million multi-tranche financing facility (MFF) for the Sustainable Urban Development Investment Program**, which aims to help Armenia upgrade its urban transport services, to improve living conditions, and bolster economic opportunities in 12 of

the country's major and secondary cities. In 2011, AsDB approved Tranche 1 for $48.64 million to improve and extend the urban infrastructure and to strengthen the institutional capacity in Yerevan.

6. **In 2009, ADB approved a $500 million MFF to fund the North–South Road Corridor Investment Program**. In 2009 AsDB approved Tranche 1 ($60 million) for improving the Yerevan-Ashtarak section of the road. Tranche 2 ($170 million) approved in 2010 finances the upgrade of the road between Ashtarak and Talin. In 2013 AsDB approved Tranche 3 for $100 million to finance continuing construction of the road to Gyumri (additional co-financing is provided by the European Investment Bank).

7. **The Crisis Recovery Support Program Loans ($80 million),** approved in July 2009, helped Armenia through the global financial crisis by allowing it to protect budgetary social spending and implement anti-crisis measures in a time of economic contraction and declining fiscal revenues.

8. **In 2007, AsDB approved a $30.6 million loan for the Rural Road Sector Project to help the government upgrade 220 kilometers of rural roads.** A supplemental financing of $17.32 million was approved in 2008 to address financial shortcomings of the project. A $36 million loan for the Water Supply and Sanitation Sector Project, approved in 2007, helped the government repair and replace water supply infrastructure in small towns and villages.

9. **With the exception of the North-South Road Corridor Tranche 2 and Tranche 3 investment program loans, all approved sovereign loans are from the AsDB's concessional ADF.** The Tranche 2 and Tranche 3 loans for the North-South road are from the AsDB's non-concessional OCR.

10. **AsDB has approved three private sector projects a total of $130 million in non-sovereign financing in Armenia and one trade finance program.** In 2013, ADB signed a $25 million loan with International Energy Corporation to rehabilitate and to improve the reliability and safety of Sevan-Hrazdan Cascade Hydropower, in a program cofinanced with the European Bank for Reconstruction and Development (EBRD). In November 2011, AsDB approved a non-sovereign lending program totaling $65 million for four commercial banks to expand lending to small and medium-size enterprises. One non-sovereign loan for $40 million was provided to Armenia International Airports for the Zvartnots Airport Expansion Project (Phase 2). The loan financed the construction of a new terminal building and purchase of equipment to supplement the existing concourse building, in a program cofinanced with EBRD and DEG (German Investment and Development Corporation). AsDB's Trade Finance Program works with four banks in Armenia and has supported over $38 million in trade.

11. **In addition to financing projects and programs, the AsDB is also involved in advisory services and capacity development.** These include technical assistance programs for urban development in secondary cities, improved access to finance for women entrepreneurs, infrastructure sustainability, preparation of an investment forum, and solid waste management. Armenia is also included in a number of AsDB's multi-country TA projects, providing assessments and development plans in topics of common interest across countries.

STATISTICAL ISSUES

(As of May 31, 2015)

Background

1. **Data provision by Armenia has shortcomings, but is broadly adequate for surveillance**. In November 2003, Armenia subscribed to the Special Data Dissemination Standard (SDDS), and the overall quality, timeliness, and coverage of macroeconomic statistics have improved significantly over the past few years. The IMF has supported this process through TA from the Statistics Department (STA), the Fiscal Affairs Department (FAD), and the Monetary and Capital Markets Department (MCM). An April 2008 data ROSC mission prepared a detailed evaluation of the quality of macroeconomic statistics. A multi-topic statistics mission visited Yerevan in February 2010 to review progress with implementation of past recommendations and follow up on outstanding issues in national accounts, balance of payments, and monetary and financial statistics. A follow up STA mission in September 2010 provided further guidance, focusing on improving the accuracy of annual and quarterly GDP estimates. Further improvements in real, fiscal, and external sector statistics would be desirable to facilitate enhanced design and monitoring of economic policies.

Real sector statistics

2. **The National Statistics Service (NSS) compiles and disseminates annual and quarterly national accounts**. The NSS also compiles and disseminates annually a full set of accounts (up to financial accounts) for the total economy and by institutional sectors. As of 2015, the NSS has been preparing the national accounts under the methodology of the *System of National Accounts 2008 (2008 SNA)*. GDP under this new methodology have been extended back to 2012, and there are plans to also cover earlier years..

3. **The accuracy of the annual estimates of the national accounts is undermined by the lack of exhaustive source data for informal activities and of appropriate price and volume indicators, particularly for construction activities**. Construction output volume measures are derived by deflating current values with a price index for output, which uses weights and base year prices from a survey in 1984. To improve volume measures of construction, the NSS has started compiling a new construction output price index based on more sound methodology. Until the new construction price index becomes available, the NSS should use other indicators for deriving construction aggregates at constant prices. The NSS should also implement new surveys to derive a proper benchmark for informal activities.

4. **The production-side estimates at current prices are derived partially from cumulative source data (from business statistics surveys) and partially from discrete data sources**. The NSS validates and reconciles data from different sources, but underlying problems associated with de-cumulating the cumulative output data distort the quarterly pattern. The NSS is currently working to produce GDP data at current and at constant prices to be fully in accordance with the SNA. The NSS

received IMF TA on estimating quarterly GDP from discrete data sources only and is using statistical techniques that conform to international standards. Recent publications of the NSS have reflected this effort. The NSS has discontinued compiling GDP volume measures at the prices of the corresponding quarter of the previous year and instead adopted the recommendation of the IMF STA mission to compile only one set of quarterly GDP estimates—quarterly GDP at previous-year average prices—and derive time series through chain-linking. These estimates would be conceptually consistent with the annual data. They would also allow comparisons between different periods, which are essential for analysis of the business cycle. Since 2012, NSS has discontinued compiling GDP on average prices of 2005 and instead they just published GDP for 2009-2012 on average prices of year 2008. As of January 2011, the NSS also started compiling a monthly indicator of economic activity (IEA), following international best practices. The monthly GDP compilation was discontinued. The monthly IEA is an implicit volume index compiled by aggregation of monthly volume indices of output using gross output weights. The CPI covers 11 large population centers and Yerevan. Since January 2011, the CPI has been computed using 2010 weights. Concepts and definitions used in the compilation of the CPI are broadly in line with international standards; source data and compilation techniques are generally adequate. The NSS compiles a ten-day and a monthly CPI. The ten-day index and the monthly index are disseminated jointly. A February data 2009 ROSC mission recommended development of an approach to include household expenditure on owner-occupied dwellings in the CPI calculations.

Government finance statistics

5. The budget execution reporting system compiles government finance data on a cash basis, supplemented with monthly reports on arrears and quarterly reports on receivables and payables. Daily revenue and cash expenditure data for the central government are available with a lag of one to two days and monthly data on central government operations are disseminated one month after the reporting period. The ministry of finance (MoF) is undertaking a comprehensive reform of the treasury system, including the introduction of an internal auditing system in line ministries and their respective budgetary institutions. A treasury single account (TSA) was introduced in 1996, and all bank accounts held by budgetary institutions were closed, except for project implementation units (PIU) that are required by donors to operate with commercial bank accounts. Since 2010 these PIU accounts also are being moved gradually to the TSA. Starting in 2002, some budgetary institutions have been converted into "noncommercial organizations" (NCOs). These units have been taken out of the treasury system and have their own bank accounts, but since 2003 report data on cash flows and balances to the MoF. The February 2009 ROSC report recommended including NCOs in the government finance statistics data published on national websites. These exceptions notwithstanding, all government receipts and payments are processed through the TSA, although there are still shortcomings on the timeliness and quality of data on the operations of local governments.

6. The budget presentation and the classification of items under the economic and functional classification of expenditures need to be made more transparent; for instance, the data have been subject to frequent reclassification, and wages for military personnel, teachers, and doctors are reported in the category of goods and services and other expense, rather than as a wage item. The February 2009 ROSC report recommended using market value rather than face value for financial assets other than loans, and for nonfinancial assets. The reconciliation of central government with general government operations is done by the NSS in cooperation with the MoF.

7. Since 2008, government finance statistics meet the classification requirements of the *Government Finance Statistics Manual 2001* (*GFSM 2001*) for the central government.

Monetary and financial statistics

8. Monetary and financial statistics are provided on a timely basis. Data on the accounts of the CBA are provided daily with a one-day lag, while monthly data on the monetary survey are provided with a three-week lag (and preliminary weekly data with a one-week lag). The balance sheets of the CBA and of the deposit money banks follow IAS methodology. Monthly interest rate data are provided with a one-week lag.

9. Responding to an IMF STA request, the CBA has compiled and submitted a complete set of monetary data beginning from December 2001 using standardized report forms (SRF). STA validated the resulting monetary aggregates, and the data have been published since the December 2006 issue of *IFS Supplement* and are used to update IFS. An integrated monetary database has also been established by STA to share the SRF data with the IMF's Middle East and Central Asia Department. The CBA also produces the financial soundness indicator table every month, published on both the IMF and CBA websites.

External sector statistics

10. In 2009, the Armenian authorities decided to transfer the responsibility for compiling the balance of payments, international investment position (IIP), and external debt statistics from the NSS to the CBA. The February 2010 STA mission provided advice on an action plan aimed at ensuring a smooth institutional transfer of responsibility, as well as consistency and continuity in the production of the external sector statistics. The responsibilities of compiling external sector statistics were *de facto* transferred to the CBA in January 2011, and since then, the CBA has compiled balance of payments, external debt, and IIP data for 2011. The transfer of responsibilities was smooth and during the short period after the transfer, the CBA undertook a number of important actions aimed at improving the compilation system. A follow up IMF STA mission in October 2011 undertook a comprehensive assessment of the institutional arrangements, data sources, methodology, and compilation practices for external sector statistics employed by the CBA, and advised on areas for improvement including further developing data sources and compilation practices.

11. The coverage of external sector data has improved in recent years, although some recent delays have emerged with the transitions towards the Eurasian Economic Union (EEU). Trade statistics are provided on a timely basis, and trade data by origin, destination, and commodity are generally available within a month. However, reporting problems have arisen in 2015 with EEU trade data. Price data for exports and imports are less readily available. Quarterly balance of payments statistics are generally available with a three-month lag. However, for remittances, there are considerable discrepancies among available source data. Remittance data obtained from surveys are considerably lower than data obtained through the money transfer system. The absence of a comprehensive, continuously updated business register hampers the coverage of transactions and institutional units; in particular, the coverage of the financial account items for the private nonbank sector. There are also concerns with regard to the collection of data on international trade in services, specifically on import of services. The CBA is currently considering the implementation of an international transactions reporting system that would allow for collecting data on all cross-border payments and receipts going through the banking system.

12. Quarterly data on the international investment position are published by the CBA within one quarter after the reference period, and the annual data within two quarters; and are also provided for publication in IFS.

Armenia: Common Indicators Required for Surveillance
(As of October 6, 2015)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	Sept. 2015	09/30/2015	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Sept. 2015	09/30/2015	D	D	M
Reserve/Base Money	Sept. 2015	10/01/2015	D	D	D
Broad Money	Aug. 2015	10/02/2015	M	M	M
Central Bank Balance Sheet	Aug. 2015	10/02/2015	D	M	M
Consolidated Balance Sheet of the Banking System	Aug. 2015	10/02/2015	M	M	M
Interest Rates[2]	Sept. 2015	10/02/2015	W	W	M
Consumer Price Index	Aug. 2015	09/10/2015	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]— General Government[4]	Q2 2015	09/01/2015	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[3]—Central Government	Aug. 2015	09/15/2015	M	M	Q
Stocks of Central Government and Central Government-Guaranteed Debt[5]	June. 2014	09/01/2015	M	M	Q
External Current Account Balance	Q2 2015	10/02/2015	Q	Q	Q
Exports and Imports of Goods and Services	Q2 2015	10/02/2015	M	M	Q
GDP/GNP	Q2 2015	10/05/2015	Q	Q	Q
Gross External Debt	Q2 2015	10/02/2015	Q	Q	Q
International Investment Position[6]	Q2 2015	10/02/2015	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extrabudgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); and Not Available (NA).

Statement by Menno Snel, Executive Director for the Republic of Armenia and Amela Hubic, Senior Advisor to the Executive Director
November 6, 2015

Mr. Snel and Ms. Hubic submitted the following statement:

The Armenian authorities would like to thank the IMF team, headed by Mr. Mark Horton, for the constructive dialogue and valuable advice in recent years. The authorities broadly agree with staff's assessment and policy recommendations provided in the report. The program's objectives to foster strong economic growth, reduce fiscal and external vulnerability, and preserve macroeconomic and financial stability remain the authorities' priorities.

Recent economic developments and outlook

Economic growth in recent years has been subdued to around 3.5 percent of GDP. Moreover, in late 2014 and 2015, the economic performance has particularly been affected by weaker external conditions, including the slowdown in Russia, ruble depreciation and lower copper prices. Remittances have declined sharply. Domestic conditions have also somewhat weakened. On a more positive front, favorable weather and strong agricultural output (following significant greenhouse investments), along with the opening of a new copper mine, have contributed to a positive growth in 2015. Unfortunately, this growth was not reflected in government revenue, which is expected to decrease, as some sectors that contributed to growth are exempt from taxes. In 2014, the fiscal deficit registered 2.1 percent of GDP, and is expected to increase to around 4 percent of GDP in 2015. This will increase financing needs and bring public debt close to 50 percent of GDP. The external current account adjusted significantly in 2015, and recorded a deficit of 4.9 percent of GDP, down from 7.3 in 2014. This positive adjustment is explained by the dram depreciation, lower remittances and hydrocarbon prices and volumes. The outlook remains challenging as the economic performance is closely linked to still turbulent/weak external conditions.

Public finances

After a successful fiscal consolidation in period 2011-2013, the weak internal and external conditions, together with some policy changes, have put significant pressure on public finances. This resulted in a higher than projected budget deficit in 2014 and 2015, -2.1 and
- 3.9 percent of GDP, respectively, and in an increasing level of public debt.

The authorities emphasize that meeting the 2015 budget target of 2.3 percent of GDP has proven difficult, since the budget implementation was aimed at supporting the weak economic activity. The budget was based on a relatively optimistic growth forecast, and revenue shortfalls were experienced due to both weaker activity and some policy changes. The expected transfers from the Eurasian Economic Union (EEU) customs pool have also been smaller than expected, due to a contraction of EEU imports this year. The expenditures were somewhat higher than budgeted mostly due to better execution of the previously approved financing programs from international financial institutions (e.g. on roads, on school modernization, and defense procurement).

The authorities consider the strengthening of debt sustainability a top priority and therefore aim to start consolidating the budget in 2016, with some further consolidation during 2017-2018, while continuing to address social and capital investment needs. This consolidation will be achieved by combining revenue measures and expenditure restraints.

On the revenue side, among other numerous measures, the authorities decided to adjust excise tax rates and to broaden the tax base by eliminating exemptions and gaps – measures expected to have a low impact on growth. On October 29, the National Assembly approved an increase of excise tax rates on gasoline and diesel fuel, vodka and cigarettes, and a new excise tax on compressed natural gas, expected to generate additional revenues in 2016. In order to bring excise tax rates in line with rates in other EEU member states, more tax rate increases are planned for 2017 and beyond. The Armenian authorities stand ready to take additional measures to offset revenue shortfalls.

Also, in order to address long-standing tax policy and revenue administration issues, the authorities have drafted a new tax code. The new tax code envisages a shift to greater taxation of consumption, a reduction of tax expenditures by reducing non-targeted VAT and income tax exemptions and incentives. Its draft version has been published for public comments in October. At the request of the government, a Fund TA mission will take place end of November 2015. A final proposed code will be submitted to the National Assembly early 2016.

On the expenditure side, the authorities will continue to improve the investment budget execution. Several important capital projects are moving ahead, including the vital 'North South' and M6 highways.

Notwithstanding recent progress, the poverty rate remains high, and the authorities continue to place importance on poverty reduction and targeted social spending. Social spending was increased by around 11 percent in the 2015 budget compared to the 2014 budget outturn. The difficult budget situation described above is likely to reflect on current spending in the coming years. However, the authorities aim to at least maintain the level of expenditures under the social programs, and if possible, even increase it.

Monetary and exchange rate policies

The Central Bank of Armenia (CBA) continues to implement monetary policy within an inflation-targeting framework with exchange-rate flexibility. The monetary and foreign exchange market decisive policy actions taken in 2014 and 2015 aimed to mitigate excessive volatility, reduce risks to inflation and preserve financial stability. While the CBA was mindful that its Q1 2015 intervention exceeded the foreign exchange sales envisaged in its December understanding with Fund staff, it considered that a larger intervention was needed to prevent disorderly adjustment. Since then, the external position has improved and the foreign exchange market has largely stabilized. The exchange rate continues to move according to fundamentals and supports the external adjustment.

The CBA believes that its exchange rate should not be related to non-floating regime. During the last 12 months the dram depreciated by 15 percent and there were more than 2 percent intraweek depreciations and appreciations. Therefore, the CBA does not share the staff's view that it is leaning against the wind.

According to the CBA, the dram is at an adequate level. Going forward, the CBA's policy is to mitigate excessive, transitory exchange rate pressures, while allowing the dram to respond to structural changes in both directions. If unexpected strong and sustained pressures emerge, the CBA will allow the dram to move to a new equilibrium level, with limited interventions to smooth excessive fluctuations.

Despite a decrease of foreign reserves following recent policy actions, the level remains above adequacy benchmarks. In this regard, the CBA continues to place high importance on enhancing reserve buffers, and stands ready to build reserves without affecting general market trends when market conditions provide the opportunity. The authorities remain confident that their policies will help in gradually reducing dollarization of savings, thereby providing an additional opportunity to acquire reserves.

The CBA remains committed to continue with strengthening the operational framework for monetary policy. As uncertainties remain high, it believes that a transparent and active communication with the financial sector, the business community and the public, both in terms of explaining ongoing developments and assessing forward-looking prospects and risks through regular press conferences and other mass-market channels will help in providing more guidance on policy actions and ensure that inflation stays within the target range. The CBA has finalized rules for an interbank money market for one- and seven-day collateralized instruments, which will play a key role in Armenian monetary infrastructure once the market develops. The CBA is also assessing mechanisms for bank rating to help clarify risks.

In the context of strengthening the CBAs independence and operations, as part of the constitutional referendum, the National Assembly is set to approve legal changes that will strengthen the CBA's mandate to pursue financial stability and the process for appointing CBA Board members. In the same context, the CBA decided that it will divest ownership of the Pan-Armenian Bank, a development bank established in 2009.

Financial sector

Improving resilience to shocks and ensuring further financial deepening remain at the core of financial sector policies. The current environment is accelerating this process. Given the strains that the current environment is placing on local banks, the CBA is implementing measures to strengthen the banking sector's resilience and efficiency. Effective January 1, 2017, a minimum capital requirement will be raised six-fold to increase capital buffers and efficiency and enhance banking services via greater economies of scale. Some banks have already increased capital, while others are raising funding or considering mergers. The CBA continues to strengthen safety nets and improve strategic risk management by requiring banks to prepare contingency plans. Additional steps have also been taken to improve and enhance the CBA's stress testing framework, including continuous assessment of adequacy of key stress testing parameters and development of new scenarios based on alternative default probabilities and macroeconomic assumptions. Also, in line with the Basel III guidance for transitioning to a risk-based supervision framework, the CBA has adopted the methodology on systemically important domestic banking institutions, with additional supervisory resources being devoted to these institutions.

Structural reforms

Although challenges on the structural front remain numerous, progress has been made in several areas. A fiscal risk assessment division was established at the Ministry of Finance, a taxpayer compliance program was prepared and an action plan to enhance tax compliance in selected sectors was completed. In addition, a policy paper on CBA liquidity and reserve management was completed, and legislation was prepared to improve the bankruptcy process. Given that the current developments might affect not only the short-term outlook but also the potential growth, the authorities decided to step up their capital spending (within the limit of available budget), but also to implement more firmly the comprehensive reforms set out in the Armenian Development Strategy.

On energy sector, the authorities are aware that the sector is going through some challenging times. In particular, the local energy companies have experienced financial pressures, due to the depreciation of the dram, slowing growth, lags in tariff adjustment and short-term borrowing. To mitigate short-term impacts, the authorities adjusted tariffs and negotiated with Russia and Gazprom lower gas prices. A decision to increase electricity tariffs was followed by public protests. Consequently, the authorities suspended the application of the higher tariffs for households and SMEs, pending completion of the external audit. The latter upheld the authorities' initial decision to increase tariffs. However, given the financial hardships of the year, the authorities decided to temporarily continue financing tariff differentials for one year, for a strict maximum of US$12 million.

The flagship pension reform is progressing well. A significant number of workers have enrolled since the revised pension law was approved in 2014. To further support the implementation of the reform, the authorities have issued an action plan with technical and policy measures, and aim to strengthen their outreach campaign in the coming months (e.g. with TV commercials, the internet, information hotlines….). Also, the 2016 budget includes funding for the Pension System Awareness Center and the outreach campaign.

The authorities continue to improve competition and the business environment. Armenia has improved its rankings from 2015 by 3 points and ranks 35th of 189 countries in the World Bank's 2016 Doing business ranking, the highest among EEU members. Recently, the authorities introduced collateral and bankruptcy reforms and SME action plans, and continued with regulatory streamlining and civil aviation reforms.

Other issues
On January 2, 2015, Armenia joined the Eurasian Economic Union. Although the current economic turbulences in the region deter the immediate benefits, the authorities expect that the Armenian EEU membership will create significant economic opportunities, including lower import prices for energy, and enhanced access for Armenian exports through the removal of customs and non-trade barriers. The authorities also expect that this membership will help mobilize new external financing for important infrastructure projects, including in energy, railroad and mobile networks, as well as improve prospects for FDI in other sectors.

The authorities remain strongly committed to further strengthening the relationship with the EU, and are working on a new framework agreement. To the extent possible, they intend to move forward with reforms aimed at harmonization with EU standards and institutions as long as these are compatible with their EEU membership. These reforms are expected to support the modernization of the economy and contribute to higher economic growth. The EU just received a new mandate from the Member States for further negotiations with Armenia. The authorities expect to continue cooperation under the Eastern Partnership Initiative and look forward to continued technical assistance and macro-financial support.

Concluding remarks
The worsening of external and domestic conditions led to some unfortunate delays in the second review of the program. Several performance criteria, agreed before this worsening, were missed. At the same time, the policy actions that have been taken have helped forestall a potentially disorderly adjustment and maintain stability. The Armenian authorities would like to reassure the Board that they remain committed to pursuing their long track record of sound and prudent macroeconomic policies, address challenges and reduce vulnerabilities through the steadfast implementation of complex policy measures included in the program and in this review.

In light of this delay, the authorities are requesting waivers of nonobservance for the missed June and continuous performance criteria. They also request that the remaining purchases under the arrangement be rephased, leaving two remaining purchases equivalent to SDR15.65 million, and subject to two reviews and SDR15.59 million subject to the last review. The arrangement will expire as planned in May 2017.

Lastly, the Armenian authorities would like to thank the Fund for the provided TA that continues to play a crucial role in supporting the reform agenda. They are looking forward to further broad TA support, which they view as indispensible for the achievement of their reform objectives.